

# Essay summary of creative accounting

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Creative accounting can be refers to accounting practices that seem to follow the applicable accounting standards but differ from the essence of those standards. It use the accounting methods to hide some elements of company's financial dealings in order to make the company appears more successful that it is in reality.

Creative accounting also can be describe as the transformation of financial accounting figures from what they actually are to what they were desire by taking advantage of the existing rules or ignoring some or all of the standards. Usually, the expectation of rewards and higher incentive compensative for executive management motivates a person to involve in creative accounting. Some of the creative accounting schemes that committed by companies include improper revenue and expenses recognition, faulty accounting in connection with business combination and wrongful us of off-balance-sheet arrangements.

WorldCom was use creative accounting in order to make the financial accounting records to look good which is the profit increasing. They was used a liberal interpretation of accounting rules when preparing the financial statements. While the company acquiring MCI, it give the management opportunity to make the creative accounting. WorldCom had devalued hard assets while simultaneously increasing the amount of goodwill of MCI. Goodwill is an intangible asset which include brand name. In USA GAAP, the goodwill is the different between the acquisition prices and fair value of identifiable assets. This enables the WorldCom each year to change a smaller amount against earnings by spreading these large expenses over decades rather than years.

The net result was WorldCom's capability to cut annual expenses, acknowledge all MCI revenue and boost profit from the acquisition of MCI. In WorldCom, the management also slight modified assumptions about the account of receivables which the amount of money that customer owed to the company. For a substantial time period, the company chooses to ignore the credit department lists of customers who not paid their bills. In these aspects, the company has two assumptions on account receivable. First, they contribute to the amount of funds reserved to cover bad debts.

The lower the non-collectible bills, the smaller the reserve fund required which resulted higher earnings. Second, if the company sells account receivable to third party, the amount or receivable considered available for sale. When the company increases the number of receivables it could sell to others to collect, by 2002 the length of time receivable had been on the company's book without collection had jumped. Months later, finally acknowledging that a huge amount of its billings were simply uncollectible. The billings that were known to be uncollectible were simply carried on the books records to avoid decreasing in earnings. In July 2002, WorldCom filed for bankruptcy protection after several disclosure regarding accounting irregularities.

They admitted that there was the admission of improperly accounting for reporting expenses as capital expenses. It is violated to Generally Accepted Accounting Practices (GAAP). Capital expenditure is money used to buy long-lasting assets, like fiber-optic cables or switches that direct telephone calls, so the cost is spread out over several years. The company says the expenses that were counted as capital expenditures involve " line costs," which are

fees WorldCom pays to other telecom players for the right to access their networks. This would make the accounting records shows gains instead of losses.

The line cost is a current expense and should be fully charge in the current period. By capitalizing the line costs will draws out the expenses over many years. This trick would allow WorldCom to turn millions of losses to billions of profit in 2001. Creative accounting occurs when companies take advantage of loopholes to show that they are more profitable or financially stable than they actually are. In some cases, companies are not yet breaking the law, but are most likely engaging in unethical behavior.

Creative accounting can lead to suspicion, audits by the government, mistrust by third parties and, in the case of fraud, even the dissolution of a company. Accounting practices in many countries have improved over the years after the Enron and WorldCom scandals, but there are still plenty of ways that companies can manipulate their financial results to overstate assets or understate liabilities.