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1. 0 Introduction

In recent years, there has been an important increase in claims about the practice of creative accounting in the corporate world. In the opinion of Coombes & Watson (2001, 89) corporate world is a legal way of doing illegal things. That means the things, which are not acceptable by the society, are acceptable in the corporate world. The concept of “ Creative accounting” has been described as “ the process by which management takes advantage of loopholes or suspicions in accounting standards to create a biased image in financial reporting”. According to Gelard (2004, 17) accounting Standards can be defined as policy documents issued by the recognised expert accounting body connecting to various aspects of depth, behaviors and disclosure of accounting transaction and takes actions against any task of the global accounting standards. However it was been argued that that new changes in international accounting standards have considerably concentrated the occurrence of creative accounting in recent time.

Therefore the primary focus of this literature review will try to explain reasons for the development of creative accounting in corporate world including any changes in accounting policy or international accounting standards and effectiveness of accounting standards, necessarily analysing the anticipation on creative accounting.

I will begin this literature review by looking at the development of creative accounting in recent years.

2. 0 Reasons for the Development of Creative Accounting

## Misleading of profits trends and lowers losses

The concept of “ creative accounting”, which at the time of appearance in the media, excited not only in American, but a global investment markets. The principle practices of this concept lies in the fact that management’s alteration of its financial results with a view to inflating profits and reduce losses. Such actions could keep stock share prices high, and this practice was closely related to the personal interests of members of the management. Creative accounting is not just an American idea. Firms have a statutory duty to carefully report on the economic results achieved and to undergo an audit of its financial records on the books. Audit firms and accounting controls confirms that according to there knowledge and experience presented to verify the accounts are properly carried out, which gives investors a guarantee that everything written in them is consistent true and applicable law. This warranty is for the auditor’s reputation market investors resulting from high competence and confidence in them. It is obvious that successfulcheatingstock investors would have been impossible without the willingness to make such a fraud on the company and management team without the inaccurate assessment of the accounting records by the auditor. Supporters of creative accounting argue that these actions that include window dressing, cosmetic accounting, or financial engineering are appropriate as they enhance the shareholder’s wealth. On the conflicting, opponents debate that these actions are against the ethical code of conduct. Whatever the motivations may be of engaging in such practices, management should not manipulate in such unethical acts under the realm of shareholder’s maximization (Watts, 2003, pp. 10).

Due to the current financial crisis, and not knowing the outcome of the current financial crisis according to Desfosses & Smith (2010, 91) most organisations are now taking a more considered, measure and creative approach to succeed, than they did in the downturn of the early 1990s. According to Mosso (2011, 419) has argued in the past, many organisations viewed success largely as transactional and an economic tool. Whereas today there is a much more curved view of total success and it’s effect on performance andmotivation.

The main motivation behind these practices is associated to the level of earnings. Management manipulates the financials to reveal a highly profitable company to the stakeholders. They adopt certain techniques to fulfill the purpose. These include flexibility in regulations, manipulation with the timing of transactions, creating artificial transactions, expanding the scope of management in terms of bad debt provisions and re-classification of the financial numbers. These techniques have proved to be useful and successful in the window dressing of accounting and financial statements.

## Income Smoothing

One alternative perspective towards “ income smoothing” is to maneuver any profit to match certain predictions. Oyen (2006) describes the way in which accounting policies are constructed “ within 5 the normal accounting rules, to match reported earnings to profit forecasts.” As the organizations which implement these actions sell their product, a considerable amount of their profits will be deferred for the future; this is with the intention of covering possible upgrades or the cost of client support. This extremely conservative system enables the straightforward calculation of future earnings. Leading figures in organizations can utilize a profit-boosting policy change in case they need to divert focus away from any less positive news. Suh (1990, 704) describes the way in which this type of change in a company’s accounting can boost an organization’s profit figures: “ by a happy coincidence distracting attention from the company slipping back from being the largest company in the industry in the USA to the number two slots.”

Shiller (1986, 406) observed the motivation of managers’ earnings “ where executive compensation is linked to income measurement and managers motivations to reduce the perception of variability in underlying economic earnings of the firm.” This allows observing the nuances across the motivation of managers within owner-controlled and management-controlled organizations. Shiller (1986, 406) found that owners who wanted to maintain their control of a majority stake were therefore, “ not interested in immediate exit strategies are less likely to be motivated to manage earnings.”

Thus, it can be seen that creative accounting can help to sustain, or even improve, share prices through the reduction of apparent borrowing levels which render an organization appear to be subjected to lesser amounts of risk, and also to create an appearance of a positive profit trend. The overall benefit of this is that it can help an organization to improve their capital from new shares, submit their shares for takeover bids, and also to withstand potential takeovers from competitors.

These motivations had a huge impact on creative accounting in the corporate world (Shalley, C & Gilson L et al 2003, 489). Due to motivation Barlev and Joshua (2004, 324) have stated making unattractive assets disappear from organisations balance sheets was one of the great secretive actions performed by accountants over the last few decades. As we found out in 2001 when Enron want into bankruptcy, this was no mean secretive action taken by accountant; this was seen to be a consequence of criminality, gross negligence, collusion and apathy.

## Examples of Manipulating Financial Statements

In the opinion of Holt & Eccles (2003, 326) “ Enron was hailed as one of the USA’s most inventive company, at its peak the company market value touched $70bn, with its shares trading at $90 each.” Yet, after the release of their October 2001 financial results in October 2001, the company declares it had made a $638m loss on the income statement, and then emphasized $1. 2bn of debt as excluded from their balance sheet. These details were shocking to Wall Street although it was not entirely unsurprising; when analysts looked at Enron’s annual accounts (1991-2001) in detail they saw that Enron was utilizing at least two accounting policies to improve their short-term profitability and to lessen any reported liabilities. Therefore Creative accounting was playing a major role in the corporate world. Whereas companies like Enron were using off the balance financing. By using motivations the company was window dressing for an initial public offering from its subsidiaries in order to manipulate investors by hiding its debts to keep its share prices high.

Holt & Eccles (2003, 326) have explained the term “ Enronitis” which was established from Enron’s downfall, this “ refers to a simple enough virus”: “ it starts with an identification of impervious accounting and ends in a share price collapse but in serious cases, bankruptcy.” Since Enron went into bankruptcy in 2001, their has been 18 Enronitis that been affected, this had a huge impact on the share price of various organizations worldwide.

Although corporatefailurehas been described as an indication of an effective market system, but not only an unexpected collapse from Enron generated a reason to be concerned regarding the deliberate accounting manipulation being utilized across corporate management. Holt & Eccles (2003, 326) have commented that “ Since October 2001, further accounting based scandals have shocked the corporate world, and has made ‘ creative accounting’ a primary topic on the agenda for governments, investors, employees, corporate management, accountants and investment analysts.” The following is a example of a companies that was involved in the accounting manipulations by corporate management:

## Xerox (USA)

In an initial complaint for fraud brought by the U. S. District Court on 11/04/2002, the U. S. Securities and Exchange Commission summarised the way in which Xerox Corporation concealed their true operating performance through the process of undisclosed accounting manoeuvres; whose alleged accounting manoeuvres “ augmented the recognition of equipment revenue by over $3m and increased earnings by approximately $1. 5bn” (Seipp & Kinsella 2011, 219). The company had two manipulations, which led to be investigated by the sec. First method was improperly storing off the balance sheet revenue and then release then in strategic time in order to boost earning. The second method was fraudulent earning, the acceleration from short-term equipment rentals, that were known as “ long-term leases.” This helped to boost the organisations profits in the short term to meet its expectations. The SEC investigation noted that the manipulation were in order to meet external expectations (Public Accounting Report 2006, 13). Without admitting or denying the Securities and Exchange Commission outlined allegations, Xerox agreed to the complaint – Xerox agreed to pay-out the $10m fine as well as summarising the financial results again for the 1997–2000 period.

Following these accounting manipulations there was no doubt that many organisations were still using motivations to manipulate its accounts. In the view of corporate management something needed to be prepared by the accounting standards in order to stop accounting manipulations from happening again. In a worse case scenario many investors have lost billions of pounds in the scandals enclosing companies like Enron, WorldCom, Xerox and Vivendi Universa. These international significant accounting scandal have produced more then 50 pieces of regulation in Congress and most of the regulations have been quiet damaging to many companies. It has seemed that changing accounting principle rules, some accountants still go in length to use creative accounting as a loophole to manipulate accounting standard. I will discuss this more in depth in the following chapter.

After looking at the development of creative accounting, I will now look at level of effectiveness of accounting standards in controlling the worrying level of creative accounting in the corporate world.

3. 0 Effectiveness of Accounting Standard

The creative accounting method was replaced by the two internationally accepted accounting standards. The 2 accounting standards that are applied in companies are GAAP and IFRS (International financial reporting standards). The effort of creative accounting is generally considered and criticized as a negative impact. The concept of creative accounting is widely associated with themes of manipulation, untruthfulness and fraud. According Bernoth & Wolf (2008, 465) suggest nowadays that “ creative accounting is a tool”, which is much comparable to a weapon: “ if used correctly, it can be huge benefit to the organization but if it is misused or goes into the hands of the wrong person.” This can be seen, for example, Enron’s accountant Auther Anderson, it can cause much harm as we seen with Enron. Creative Accounting has developed from the early 1990’s and has since assisted a wide range of organizations to avoid a financial catastrophe than place them into a deeper crisis. Creative accounting techniques are virtually always innocent; whenever it appears the liability lies with the organization (Bernoth & Wolf 2008, 465). Keith (2007, 45) states that there have been many cases where organizations “ have benefited hugely by using creative accounting techniques and remained secured during difficult times.”

The primary objective of any financial manager is to maximize shareholders wealth. However, this objective is misinterpreted by the organizations. In today’s scenario, it has become a practice that the compensation of the employee is linked with its performance. This leads to some unethical and self-centered decisions on the part of managers. Nick (2008, 32) describes how these bodies “ engage in risky ventures to gain maximum bonus or reward. Although, it provides them advantage in the short term, however, it is against the objective of maximization of shareholder’s wealth.” This results in Agency conflict. To minimize this issue, organizations provide employee stock options as per which the employees are shareholders of the firm. In this way, their decisions are always aligned with organizational objectives and shareholder’s interest.

## IFRS as a Key Accounting System Innovation

International Financial Reporting Standards (IFRS) is the combination of accounting standard and is which outlines the way in which various types of transaction and accounting events must be displayed in thefinancial statement. The International Accounting Standards Board declares it. IFRS aims to unite accounting standards across the world under one universal standard which is simultaneous in its consistency, transparency and compatibility. This has come about “ according to a fact financial regulators in several countries have generated high demand for IFRS compliant financial statement” (David, 2008, 56). The IFRS for Small and Medium size corporations was published as an introductory plan by the IASB in 2007 and was primarily introduced for organizations which had no publicaccountability. If the organization’s shares or debts floated in the public exchange or financial institution company, then there would be Public Accountability because the IFRS for SME (IFSME) “ have capabilities to apply in the large range of private organizations” (David and Christopher, 2008). Across over 100 different nations, over 11, 000 organizations have appropriated IFRS in some capacity, while many other nations strive to apply these standards annually with the anticipation of increased comparability of financial statement.

## IFRS: A study in Poland

As it is known, one of the basic elements of the European Union’s new strategy in the field of financial reporting is the requirement of preparation of consolidated financial statements by all companies listed on the EU capital markets according to International Financial Reporting Standards from 2005 onwards (Perry and Nolke 2006). The mentioned obligation also refers to those companies listed on the Warsaw Stock Exchange, which prepare consolidated financial statements, and it is a big challenge for Polish practitioners, both the accountants and auditors. Not long ago in Polish practice of financial statement had a strictly defined form and scope, and was treated by the people preparing it as the only possible, obligatory model. The changes resulting from the incorporation of IAS in 2005 to the Polish accounting law didn’t determine the change of the financial reporting model, but only itsreconstructionand complement (Walinska 2010, pp22).

In order to verify the model of development trends in the presentation of the balance sheet drawn up by the IASB accounting standards in the Polish practice an analysis of balance sheets under IFRS at the end of 2008 was done. The study involved 162 companies, and its objective was to examine the trends identified in the analysis of balance sheets for the year 2005 for listed companies with the WIG 20. On this basis, ‘ average’ balance sheet according to IFRS was prepared. It included only those items, which had been disclosed by more than 50 percent of surveyed companies (Walinska 2010, pp22).

The results of the empirical survey in 2005 and 2008 showed Number of balance sheet items in 2005 were limited to 30. In 2008, examined the number of items in the assets fixed and current, the liabilities and equity. The company revealed an average of 7 items in current assets and fixed assets. The number of items disclosed in shareholders equity amounted to an average of 6 and all companies that are presented net profit for the current period and the remaining equity, 5 items for companies presented in equity, retained earnings and other capital. The number of items disclosed in the liabilities was on average 10, in which 4 items in the long-term liabilities, and 6 in the short-term liabilities (Walinska 2010, pp22). Clearly more items in all sectors were disclosed. In summary, comparing the average number of items in its balance sheets in 2005 and 2008 should be noted that the trend endures and varies around the number 30.

## GAAP

Generally Accepted Accounting Principles (GAAP) is the standard of accounting which is implemented across American and other nations. GAAP differs to in that it is regulated in detail for the GAAP of the accounting treatment of particular practical situations. In 2008, the Securities and Exchange Commission issued a preliminary plan (Eng. Proposed Roadmap) for the movement of the IFRS and non-GAAP. Foreign companies are allowed to flow with the SEC reporting standards IFRS. All U. S. companies are required to publish reports on US GAAP, which is considered the gold standard of accounting, because it minimizes the abuse and the most consistent users reporting purposes. In February 2011 the SEC issued another document in which he has not taken the decision to implement IFRS in U. S. Reporting on shifting desires Boeing Inc, PepsiCo Inc and other companies in terms of the mandatory introduction of the years 2015-2016 (Charlotte, 2007, 23).

## ISA 39

The accounting standard IAS 39 establishes principles for recognizing and recording an organization’s financial assets, liabilities and any contracts to buy/sell non-financial objects. Changes in International Accounting Standards in 2004 lead to IAS 39 which required institutions lendingmoneyto set aside fewer provisions against future bad debts, this allowed the institutions to show higher profits and lend more money without setting aside sufficient provisions. RBS reduced provisions as a proportion of problem loans from 72% to 62% between 2004 and 2006 in accordance with IAS 39; HBOS reduced their provisions from 40% to 38% over the same period despite taking on increasingly riskier mortgages (Aldrick, 2011).

Santander however, went against this trend and IAS 39 by increasing its provisions against problem loans from 51% to 65% from 2004 and 2006 in order to be more prudent, when the Global recession began in 2008, the provision set in accordance with IAS 39 were significantly smaller than required. The article states that some Accountants have suggested that it is no coincidence that Santander prospered during the financial crisis whilst other financial institutions suffered greatly.

This article also looks at Dunfermline Building Society who collapsed amidst the Global recession. Whilst being audited in December 2007 the society’s management were said to have over-provisioned against commercial property losses by their auditors Deloitte who felt that the market conditions of the time were favorable and therefore the provisions should be reduced in accordance with IAS 39. However within 15 months of this Dunfermline Building Society had collapsed and been nationalised, mainly due to huge losses on its commercial property loan portfolio against which it had taken insufficient provisions (Aldrick 2011).

This article has shown that not only do accounting standards fail in preventing Creative Accounting on occasion; the standards themselves can be motivation behind Creative Accounting. The management of Santander went against IAS 39 in order to protect the company and this was shown by the company’s performance during the Global recession, if Dunfermline Building Society had looked to go against their Auditors Deloitte and IAS 39 then maybe the company wouldn’t have suffered the way it did.

## Financial Accounting Standards Board (FASB)

The Financial Accounting Standards Board (FASB) is a member body designed to regulate the accounting standards applied across America. The standards which are governed in the FASB are “ FAS”, or “ SFAS”, now constitute the U. S. GAAP. Richard et al. (2010) describes how the FASB is “ primarily concerned with the development of accounting for financial reporting by large companies by providing a guideline for implementation.” FASB offers public resources to “ understand the limitations and nature of the information shared in the financial reports” (Nick & Kenneth, 2008).

Both the FASB and IASB have agreed to invest particular effort towards the completion of any major shared projects. This partnership is committed to the development of IFRS and is crucial towards reaching thegoalsusing milestones. Moving away from US GAAP will let FASB and IASB to converge with IFRS. There is a consistency in the steady support given towards a singular goal of high-quality international standards.

Their work and efforts will achieve similar set of high quality standard with the independent standard setting process. FASB and IASB work alongside the IFRS to achieve a primary target of improving international comparability through the eradication of any dissimilarity.

Both groups aim to improve the global accounting standards; believing that this will improve the standards of financial reporting, not just in America, but all over the globe. Barry (2008, 41) states that “ the high quality standards were challenging and difficult, but they successfully met the challenge and continue their intensive and collaborative work. They have always tried to improve in their learning process, and that have given them success.”

Moving towards implementation of IFRS will make vital change in Businesses and even accounting professionals. They will begin preparing for these important changes in accounting standard. Accounting mentors should take immediate action and organize their students for this dramatically change, which will affect not only accounting, but also core financial aspects of alleducationsystem, financial institutions, and other companies (Alan, 2007, pp. 12).

4. 0 Conclusion

In summary, the argument regarding “ creative accounting” is thus; there is a difficulty surrounding the concept which deviates from the fact that, currently, there is nothing in place which can completely restrain the abuse of creative accounting. In recent history, the misuse of standard creative accounting practices by large corporate bodies has tricked auditors and regulators – for example in the case of Enron and WorldCom – and there are many organizations which continue to do so. The diverse nature of business transactions within current accounting standards and policies mean that it is difficult for audits to manage the proper use of creative accounting. The problem does not revolve around the implementation of creative accounting solutions, but the focus of the disclosure level that influences the justification and nature of the accounting system. It is the difficult pronouncement regarding the future of creative accounting standards in the U. S which raises nuanced and complicated issues. There exist significant remuneration for potential investors, organizations, and the overall economy of having the international standard of creative account to a single, uniform set of top-quality accounting standards, there exist a range of factors which that have to be calculated when making this kind of conversion. As outlined in this study, implementing IFRS will generate a persuasive effect over the projects under the various accounting systems. Creative accounting scandals have also seen corporate bankruptcy, which as a result has requested the need for improvements in accounting. These events have directly led to the formation of a enterprising new accounting standards body, the Accounting Standards Board, and “ the issuance of a whole surplus of new accounting standards aimed at removing deliberate accounting manipulation” (Madsen 2011, 1679).

5. 0 References

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