Financial reporting essay

To manipulate profit to match forecasts. Fox (1997) reported how Microsoft designed its accounting policies, within normal accounting rules, to match reported earnings to profit forecasts. It deferred large part of the profit, generated from software sales, to future years to cover potential upgrade and customer support costs, thereby the company's future earnings were predicted easily. Secondly, Company directors keep an income-boosting accounting policy change in hand to distract attention from unwelcome news.

Collingwood (1991) reported on how a change in accounting method boosted K-Mart's quarterly profit figure by some $160 million, by a happy coincidence distracting attention from the company slipping back from being the largest retailer in the USA to the number two slot. Creative accounting also helped maintain or boost the share price both by reducing the apparent levels of borrowing, so making the company appear subject to less risk, and by creating the appearance of a good profit trend. This helps the company to raise capital from new share issues, offer their own shares in takeover bids, and resist takeover by other companies.

Looking at the reasons above one might wonder the ethics behind these practices. Revsine (1991) offered some defence for these practices by drawing heavily on the literature of agency theory. He believes that both the management and the shareholders reap benefits from these 'loose' accounting standards. On one hand the manager is able to manipulate income so as to maximize their bonus settlements. On the other hand shareholders benefit from the fact that managers can manipulate reported earnings to 'smooth' income since this may decrease the apparent volatility of earnings and so increase the value of their shares.

At the heart of this analysis are the following implicit views that: *? the prime role of accounting is as a mechanism for monitoring contracts between managers and other groups providingfinance; *? market mechanisms will operate efficiently, identifying the prospect of accounting manipulation and reflecting this appropriately in pricing and contracting decisions. As mentioned in the beginning a financial accountant's vital role is to safeguard the firm's financial statements from fraudulent manipulations.

Increasingglobalization, which means adoption of common accounting practices means that the accountant must ensure that the changes are implemented systematically and the protocols are maintained throughout. Estimates and creative accounting are attractive tools for manipulating critical figures and mislead the investors. Whereas these methods have its own advantages, the financial accountant should not forget the mishap it will cause if used improperly. On the whole, in order to perform his task with integrity the financial accountant needs to be proactive in his approach and be critical when analyzing financial statements.