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The Effect of Creative Accounting on Firms' Financial Health This study is undertaken to analyse the role that creative accounting is playing in firms' experiencing financial strain and others collapsing. The research will be guided by three main objectives, which include identifying the effect of creative accounting on firms' financial strength, assessing the relationship between creative accounting and financial strain and finding out the methods used in creative accounting. The researcher will use theories and scholarly reviews to explore on the practice. The researcher will sample selected firms that have collapsed due to financial strain and research on their financial statements. Interviews and questionnaires will be used to obtain primary data, while financial statements will be used to obtain secondary data.

Background of the Study

The increased collapse of companies led to an increase in the number of legislation passed to protect businesses and the interests of shareholders (AICPA 6). This has led to an increase in creative accounting, which is the manipulation of financial statements by accountants using their knowledge, in a way that is within the legal restrictions (Beidleman 655).

Without rotation of auditors, and with accountants being under the command of managers, they can manipulate them to produce financial statements that do not portray the true and fair view of a firm's financial performance (Hanno 135). There are various reasons advanced to explain why firms engage in creative accounting. These include a company trying to hide its poor performance in a particular year, or when it is avoiding takeovers (DeZoort,

Hermanson and Houston 179).

Statement of the Problem

Accounting standards have been revised to try curbing unethical issues in financial statement preparation and improving their integrity. However, managers and accountants have found ways of navigating this regulation; remain within the confines of the law, and produce financial statement that do not reflect the actual position of a company. This has led to such companies experiencing financial strain and others collapsing.

Research Questions

- i. What is the effect of creative accounting on the financial performance of a firm?
- ii. Is there a relationship between creative accounting and collapse of firms?
- iii. What are the methods used in creative accounting?

Significance of the Study

The purpose of this study is to find out the impacts that creative accounting has on a company's financial health. The study will give an insight on the consequences of creative accounting and the negative effects the practice may have on a company's on-going and future performance.

Literature Review

Various scholars have studied different aspects of creative accounting. According to Beasley, creative accounting is used to influence market expectations and increase consumers' and investors' confidence in a firm (450). Financial analysts use financial statements to value stock and this encourage managers to do creative accounting to purport improved earnings, which in the real sense are poor (Oyadonghan 131; Cohen and Hanno 143-4).

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Cormier carried out research on the involvement of auditors in creative accounting and found that trust and loyalty between auditors and managers contributes to this (137). Vladu and Matis also came to the same conclusion in their study focused on relating creative accounting to corporate governance (332). To curb the practice, Bazerman, Loewenstein and Moore advocated for rotation of audits in a firm (99). Bedard, Chtourou and Courteau agreed with this recommendation arguing that it will discourage formation of unhealthy relationships between managers and auditors (30).

Methodology

The research will use both a quantitative and qualitative methods of collecting and analysing data to establish the effect of creative accounting on the financial performance of a firm. Interviews and questionnaires will be used to obtain primary data while financial statements will be used to obtain secondary data. Statistical analysis will be used to conduct the analysis.

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