

Impact of Creative Accounting on Financial Performance

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ABSTRACT

Manipulations in the financial statements that are done with the help of loopholes in accounting standards, laws and regulations, called Creative Accounting. By Manipulating the financial Statements companies can conceal their actual financial position. This disables the transparency of financial reporting and presents a more favorable picture than what they truly exists. The objective of this research is to identify the Impact of Creative Accounting on financial performance, Investors and Stakeholders. Strong desire for money, power, competition, success and prestige produce Creative Accounting negatively. But in a positive way, sometimes Creative Accounting can be used as a weapon to save the company from Crisis. Similarly, If the company does not underestimate the economic impact of Creative Accounting and uses it like a short term medicine, then the negative impact on investors will be less. This article explains Creative Accounting through some case studies also.

Keywords: Creative Accounting, Manipulation, Financial Statements, Loopholes, Financial Scame.

Introduction

'Two-faced' is one that usually means that someone presents a nice or good front, but is truly the opposite. Something like that also with Creative Accounting. Creative Accounting, The name suggests that there will be an attempt to present accounting in a new way but in reality it does not match with. In simple words The methods, which are used to fool Investors, are called Creative Accounting. Creative Accounting is to do manipulation in a new way. The name Creative Accounting is positive but the work is negative. In this article it has been found that Creative Accounting has as much positive impact as it has negative. Along with the objective of research in this article, Creative Accounting Concept, Need, Techniques And consequences have also been discussed. In this study it has been observed, how much positive and negative impact does a company have, by adopting Creative Accounting. There have been many such scams in India and worldwide in which investors have been defrauded. In today's time Creative Accounting emphasis is being laid on reducing its use or using it for short-term purposes only. There has been discussion about how Creative Accounting should be triggered. In the end it was found that Creative Accounting results are more negative, for this, the authorities like SEBI, ICAI themselves are emphasizing on reducing it. There are more negative impacts than positive ones.

Concept of Creative Accounting

Meaning

Manipulation in the financial statement with the help of loopholes in accounting Standards is called Creative Accounting. Here Creativity means Manipulation without violating the rule.

Creative Accounting is described as ,Following the accounting Standards but deviating from what those standards want to achieve.

Loopholes in accounting standards have prepared the way to some creative accounting practices. Resulting is a loss of "true & fair" picture. Within the ambits of accounting standards, the Creativity can be legal. Creative Accounting is used to win investor's confidence. Creative Accounting is misuse of knowledge. In short, Company's financial Statements are not providing a true and fair view with the use of Creative Accounting.

Various Terms

Various Terms used for Creating Accounting:

- Earning Management
- Window dressing
- Financial Engineering
- Cosmetic Accounting
- Earning Smoothing ,and
- Aggressive Accounting etc

Objectives of the Study

- To recognize the conceptual content of Creating Accounting practices in Indian Financial Sectors.
- To study the importance of Creative Accounting and understanding the consequences of Creating Accounting on financial performance, Investors and stakeholders.
- To study the benefits and drawbacks of Creative Accounting Practices
- To analyze the Creative Accounting Practices in the Indian financial sector, illustrate with some case studies.
- To identify regulatory Measures and preventions.
- To determine the role of Auditors in Creative accounting.

Review of Literature

Suman Nayyar (Creative Accounting-Offence Or defence) stated that Exactly Creative Accounting is not illegal if it is used within the ramification of Accounting Standards, laws and principles. Try to use it as a short- term solution only without making an offence against other users.

CH. Deepthi (A study on Creative Accty) observed that In India most of Scams are influenced by Political leaders also. Both the public and private banks have been practicing the Creative Accounting but Indian financial sector does more manipulations as compared to Banking sector and IT companies.

M.L. Bhasin (creative accounting: An empirical study) recommended that the choice of accounting method should be demoted. Auditors play a crucial role in identifying and reporting the true and fair picture of business So they should be given the responsibility to trace the frauds.

S. MUDEL (Creativity Accounting and Corporate Governance) investigated that if Corporate Governance is related with Creative Accounting then Negative Impact of Creative Accounting can be significantly reduced. General trends which are identified support the Negative points of Creative Accounting more.

Sources of Data

Secondary Data has been used to understand consequences and techniques of Creative Accounting. Data has been mainly collected through the company's website and newspaper itself.

Need for Creating Accounting

- **Negative Approach of Need**
 - Desire for money, power, competition, success and prestige produce Creative Accounting negatively.
 - The fraud took place to divert company funds into real-estate investment. Keep high Earnings per Share, and make huge profits by selling stake at an inflated price.

- The competitive environment and the pressure to show good and improved financial results, to declare a higher dividend, to stabilize profit.
- **Positive Approach of need**
 - Creative Accounting, sometimes, can be used as a weapon to save the company from crisis.
 - Sometimes, Creative Accounting never harms any of the stakeholders.
 - Using a creative accounting tool, the companies were able to show profits, or Minimize losses, during a difficult period.
- **Techniques of Creative Accounting**
 - Revenue Recognition or Overestimating revenue (Aggressive Revenue) and Income Smoothing
 - Off- Balance sheet financing
 - OverProvisioning for accrued expenses when profits are high
 - Expenses Capitalisation and Extended amortization - a Timing Differences technique
 - Increased provisions to reduce profit or decreased provisions to increase Profit
 - Corporates tend to show cash inflows from financing or investing under operational activities to mask the negative flow under Operating activity.
 - Inventory Manipulation
 - Delaying expenses.
 - Lowering depreciation charges
 - Masking contingent Liabilities.
 - Cookie jars Reserves and
 - Companies may overvalue assets or under- value liabilities to manipulate financial Ratio etc.
- **Consequences**
 - Mislead investors
 - Mislead creditors to continue their association with the company when it is time to exit.
 - Investment decisions are based on financial statements, because the financial statements depict a "true and fair" Image But Because of creative accounting techniques, financial statements present a less "true and fair" picture . Manipulated statement Causing misleading ratio and indicators that investors rely on to make investment decisions. For example:-
 - Artificially improved liquidity & Solvency Ratio
 - Overstated profitability & Efficiency measures
 - It allows individuals to comprehend the potential damages such as investor loss and erosion of trust.
 - Eroded trust causing long-term harm to the overall economic system.
 - Creative Accounting distorted financial performance. This can be misleading stakeholders, damaging the credibility of financial statements.
- **Some Economic Impact**
 - Creative Accounting can lead to inflated stock prices.
 - The overall economy can be negatively affected due to erosion of investor trust.
 - Creative Accounting makes wrong decisions ,causing market bubbles and leading to financial crises with far-reaching economic implications.
 - Both Systematic risks and financial instability can be activated by various factors such as excessive leverages, inflated values and moral losses. Circumstances. can be leading to Market Crashes, Bank failure and economic recessions.

Case Study

- The origin of creative Accounting is claimed to have come from Enron, 7th largest corporate in the U. S. at that time with falsely inflated accounting practices. This scam took place in 2001. This came to everyone's attention when its earnings were increasing while it had huge bad debts. They used off- Balance sheet techniques to keep their debts.
- The WorldCom scam took place after Enron. in 2002. The company was found to have inflated earnings by capitalizing expenses. The collapse of WorldCom was one of the largest bankruptcies in U.S.

Creative Accounting in India(case study)

Satyam Computer scam: Company was found guilty in 2009. The scandal had a significant impact on the Indian Stock market.

- The Satyam Scandal is a classic case of negligence of fiduciary duties, total collapse of ethical standards, and a lack of Corporate Social Responsibility.
- Overstated assets and underreported liabilities.
- Weak internal audit and control system.
- Inflated income statements and bank accounts to meet expectations.
- Created fake bank accounts, salary accounts, invoices and customer I. D. Etc.

Some latest scam in India through Creative Accounting:

MBL (Manpasand Beverages Ltd.) Scam

The company was set up in 1998. In 2019, SEBI banned MBL from the securities market for a period of three years and also imposed a total penalty of Rs. 74 lakh for manipulation and misreporting the financial statements.

Before unravel the scam:

- The company was set up in 1998. The company focused on rural markets and cities to grow its presence as opposed to its Rivals who made metro's for their target in 2018.
- The company's distribution was at its peak with 6,00,000 outlets across India. MBL had plans to set up its another plant.
- The situation worsened when its auditor resigned in May 2018.
- In 2019, CGST commissionerate showed that the company had used this network to operate through fake units.
- MBL head created invert and outward transactions made with such bogus firms amounted to rs. 188 crore and Rs. 691 crore respectively.
- Its top officials were arrested for GST fraud of over Rs. 40 crore .

Finding s After scam:

- Publication of manipulated and misreported financial statements, untrue and misleading financial results which presented a false picture of financial health during 2018-19 and 2019-20.
- Manpasand Beverages (MBL) had created 38 bogus firms to inflate its turnover, and inward and outward transactions made with such bogus firms amounts to Rs. 188.48 crore respectively.
- SEBI Commissioned Auditor to perform a Forensic Audit on the company's financial Statements. The auditor's findings:-
 - purchases from unregistered traders without actual transactions.
 - inflated-sale figures
 - dealing with entities that had not complied with GST filing requirements
 - sales to dubious entities
 - overstated figures for impairments, receivables and Fixed assets.

- SEBI had also found that MBL had deficiencies in internal controls and had published misleading financial statements for 2016-17 and 2017-18.
- MBL were found in violation of the LODR regulations and Securities Contracts Regulations act (SCRA).
- MBL also used Input tax credit from fake invoices for payment of GST Liabilities, resulting in a loss of GST revenue to the exchequer.
- Essentially everything was fake. The company existed only on the stock market and not in the real world.

SEBI bans IWIL(Indus Weir Industry Ltd.)

- Raising funds from investors by issuing non-convertible Preference Shares and not followed the process of issuance of securities through public issue norms and SEBI (NCRPS) regulations.
- The matter was examined by SEBI in 2023, it was observed that IWIL had mobilized money amounting to Rs 33.39 crore through issuance of RPS from 32,454 investors during the FYs 2010-11, 2011-12, 2012-13 & 2013-14 Without public issue norms.

Finding and Analysis of Creative Accounting

Tips for Identifying Creative Accounting Practices:

- Beware of significant changes in financial trends that are inconsistent with industry standards.
- Review complex financial statements that are not easily understandable.
- Examine the conflicts between & company's financial Statements and Operational statements.
- Examine the Independence and quality of the company's Auditors.
- Companies that consistently meet their profit expectation should be monitored.

Various Preventive Measures

- Increasing autonomy for internal auditors.
- Establishing a better Corporate Governance environment Ensure that there is effective oversight,accountability in financial reporting, accuracy and transparency of financial Statement,
- making reinforcement interventions to managers on the code of ethics.
- Adopting forensic Accounting as a preventive tool rather than a post-mortem Mechanism.
- Concealment of losses and liabilities effects on decision-making on resources allocation.This highlight the need for oversight to prevent the negative effects on decision- Making and Research in the form of fines and lawsuits.
- Authorities like SEBI,RBI, ICAI should impose strict penalties, imprisonment or bans for those engaging in misleading activities.
- Public awareness campaigns and educational programs must be established.
- Strengthening accounting regulations and standard
- Regulatory Agencies and Professional organizations facilitate the enforcement of Auditing standards and hold Auditors accountable for their actions.
- Strong Internal Controls help identify the risks, reduce the frauds, ensure compliance with financial reporting,regulations, protect stakeholder interests and ensure the integrity and reliability of financial information will be maintained.

Conclusion

Creative Accounting is a double-edged sword - it may be used or abused by corporates.

Strong desire for money, power, competition, success and prestige produce Creative Accounting negatively.If the company does not underestimate the economic impact of Creative Accounting and uses it like a short term medicine, then the negative impact on investors will be less.In today's time Creative Accounting emphasis is being laid on reducing its use or using it for short-term purposes only.

Therefore, it is crucial for regulators and oversight authorities to enforce strict regulation and penalties to discourage Creative Accounting practices and ensure the accuracy of financial reporting. When instances of Creative Accounting come to light, Mostly it often results in significant reputational damage and loss of shareholder value. President Draupadi Murmu encouraged to adopt smart technology which will conduct accountancy in the right spirit. Also said that there will be no more space for Creative Accounting in future due to fast-evolving technology in the Auditing Area. In the end it was found that Creative Accounting results are more negative, for this, the authorities like SEBI, ICAI, RBI themselves are emphasizing on reducing it.

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