

A Study on Creative Accounting Practices in Indian Financial Sector

Prof. Vidhi Paryani
Assistant Professor,
St. Paul Institute of Professional
Studies, Indore

Dr. Vishal Mehta
Principal, College of Professional
Studies, ATC

Abstract

The prevention and detection of accounting manipulation, in particular, is regarded as 21st-century phenomena that has garnered increased attention in the wake of the global economic crisis and budget deficits. Using accounting expertise and regulations that do not directly contravene accounting norms, rules, or laws, creative accounting is a practice that has an impact on financiers. When creative accounting is used, the primary goal is to convey to stakeholders the desirable financial situation that the management of the company wants them to see. Financial information can be manipulated by creative accounting by taking use of regulations that are already in place or, frequently, by ignoring one or more of them. Therefore, by methodically examining the impacts, the present work's methodology adds to the body of existing material. "In the business world, nearly all public accounting have been derived from books of accounts that have been fully roasted or cooked just right. Remarkably, there aren't many gaps in the accounting standards that allow for the application of "Creative Accounting (CA)" techniques because a great deal of financial number-crunching is done in accordance with existing accounting rules and applicable laws, CA methods do not offer a "true and fair" image of the FS(s) as there are groups that support and oppose the use of such tactics, the usage of CA has recently gained controversy. The goal of the CA profession is always to provide accountants, managers, and businesses an unfair advantage. The research paper focuses on the use of CA in the financial sector, techniques and motives of creative accounting. It also studies the motive behind the use of CA in financial sector.

Keywords: Creative Accounting, Financial Sector, Financial Statement, GAAP, IFRS.

Introduction

The topic of creative accounting has always been contentious, with a growing number of viewpoints in the accounting literature. These claims are supported

by double evidence. Either adverse or positive accounting is provided by this system. While negative creative accounting is based on "inappropriate" accounting methods that may be misleading to those who utilise accounting records, positive creative accounting is based on "fair" accounting procedures. Financial information management, also known as income smoothing, earnings management, creative accounting practices, and account manipulation, prevents money from going to the most productive economic sectors. Accounting procedures that may or may not adhere to accounting standard practices' guidelines but unquestionably deviate from them are included under creative accounting. Undoubtedly, creative accounting techniques can exist in extremely regulated economic environments. rather than presenting the true state or accomplishments of the business, the executive using creative accounting practices applies accounting expertise to present accounting data, records, and reports in a way that is highly visually appealing to investors. All of this is done while adhering to accounting standards and regulations.

Definitions of Creative Accounting: There are several numerical ways to define the term "creative accounting." First, let's define it: "a practice in which accountants alter the figures stated in an entity's statement of finances by using their knowledge of financial rules." The science and skill of making the accounts appear appealing while staying within the established performance standards is known as creative accounting. In the natural world, creative accounting causes a vessel of water that is halfway full to appear half-empty. The term "creative accounting" describes the application of accounting expertise to manipulate reported numbers while adhering to legal and regulatory requirements. This results in the reported numbers reflecting the management's desired narrative to participants rather than the organization's actual achievement or place.

According to Copeland (1968) Creative Accounting involves repeatedly choosing measurements in accounting or reporting practices in a specific pattern, with the goal of presenting an income stream with less variance following norm than would have generally occurred.

In 1992, Kamal Naser "Creative accounting is the process of using the current regulations and/or disregarding any or all them in order to change the financial accounting numbers from what they truly are to whatever the accounting professional desires."

"Using the ability to adapt in accounting within the framework of regulation to manage the assessment and representation of the books so that they give confidentiality to the interest of the preparers, not the users" is how Jones (2011) defined creative accounting in the end.

Literature Review

In the 1970s, creative accounting first made its appearance in Anglo-Saxon literature. It was most frequently mentioned in articles by Watts and Zimmerman (1978, 1986, 1990), which laid the groundwork for positive accounting theory, and in publications concerning business bankruptcy. This study trend became the focus of multiple empirical studies that attempted to clarify financial decisions by beginning with the issue of the political expenses that the businesses are subjected to. In the past few years, a collection of 12 accounting procedures was chosen by Brown and Steele (1999), who also combined the accounting alternatives with the management choices. Apart from the political expenses, the significance of the business and risk sector as well as the company operation is highlighted as important factors that influence creative accounting.

According to Burlacu and Pătroi's (2005) beliefs, creative accounting is utilised to mislead the socioeconomic-financial metrics of the business entities while maintaining their informative value through "consolidation." It is acknowledged that this modifies the consistency and veracity of the accounting data that the economic entity transmits to the business community.

When it comes to attracting interest in creative accounting, Romanian literature is lacking. According to Feleaga and Malciu (2002), creative accounting is a method by which accounting experts apply their expertise to change the numbers that appear in the yearly accounts.

Colasse in 1996 sees creative accounting as a collection of accounting information methods that certain economic entities use to enhance the appearance of their financial position and economic-financial performances, while staying within the bounds of legitimacy. He further notes that these behaviours develop not only because of normalisation boundaries but also because human inventiveness knows no bounds. We shall stand by our statement that "it would be incorrect to assume that the regularisation and normalisation present a financial picture of the enterprise objectively." They just make the painting technique of this portrait explicitly visible. However, they delegate a manipulation line to the account preparers in the same.

Trotman (1993) expresses creative accounting in a nearly similar way, noting that this communication strategy aims to improve the quality of information given to investors. Consequently, the business entity is showcasing itself to current or potential investors.

Financial statements were filtered using certain methods that might provide the

appearance of better outcomes than the typical ones while also giving the statements a more positive image in the market.

According to Naser (1993), innovative accounting can be summed up as follows: 1) the process by which accounting figures are manipulated because of some rule breaches; 2) the process by which transactions are structured in a way that permits the "production" of the "desired accounting result." By applying this adaptability, they select those assessment practices that allow the amalgamation of papers to be transformed from what they ought to be into what the managers want.

From the standpoint of an a professional, Jameson (1988) recognises how the method of accounting fundamentally necessitates functioning with many ideas and objectives. Some less ethical bookkeeping professionals resort to tampering deception, and falsification as a result of this diversity. He is the one who claims that these innovative accounting techniques adhere to the letter but not the spirit of the law because they do not violate any laws or accounting standards. Jameson thus highlights the detrimental aspects of creative accounting, which deceive users of the financial data and misrepresent the company's financial performance and positioning.

Objectives of the Study

- To determine the techniques used in Creative accounting
- To study the motivations of the Indian financial sector for the use of Creative accounting.
- To analyze the impact of Creative Accounting on various stakeholders and the economy as a whole.

Techniques of Creative Accounting: The fundamentals of creative accounting approaches are diverse, and the regulations governing them are always evolving. Here are a few inventive methods for accounting:

- **Overestimating Revenues:** Early revenue recognition is one of the most popular strategies employed by publicly traded corporations to inflate their earnings. Using the accounting method of revenue recognition, businesses can track revenues prior to they provide a good or complete a service.
- **Postponing Expenditures:** Postponing the entry of current period costs, like rent and supplier payments, as well as to a later period improves the appearance of present period earnings.
- **Reducing Amortisation Costs:** Instead of expensing all of an asset's cost at once, businesses usually stretch it out over time. Increasing the asset's

assumed salvage value or prolonging the asset's estimated lifespan are two ways to lower the yearly expenditures on these items.

- **Modification of Inventory:** the worth of manufactured but unsold items is represented by stock. If genuine stock and revenue levels stay the same, overstating the value of inventory will result in an underestimating of the cost of products sold and, thus, an artificially greater net income.
- **Covering Contingency Liabilities:** Understating the expected cost of potential liabilities and failing to register them might increase the company's net profit or the equity of shareholders.
- **Undervaluing Pension Liabilities:** Since pension obligations are projected and must be taken into consideration using company-generated estimates, they are prone to manipulation.
- **Related-Party Transactions:** Transferring revenue or loss among firms through executing transactions at non-market prices with associated parties.
- **Cookie Jar Reserves:** To equalise earnings, set aside money during prosperous years and release it during unprofitable ones.
- **Channel Stuffing:** During a reporting period, sending extra inventory to suppliers or retailers in an attempt to artificially boost sales.
- **Big Bath Accounting:** Making subsequent results seem higher by making a huge one-time charge during a time when productivity was already subpar.

It is imperative to acknowledge that whereas certain methods may fall within the purview of accounting regulations, others may be illicit or deceptive. To identify and stop this kind of tampering investors and authorities keep a tight eye on the accounting records.

The Motives of Creative Accounting

The goal of creative accounting is to inflate the organization's perceived financial condition. The term "creative accounting" describes artistic account presentation. These approaches depart from the fundamentals of accounting laws. But they're not against the law. There could be a number of causes for creative accounting. To protect business owners, inventiveness on its own can occasionally originate from the individual who handles the books of accounts. It's time to consider whether this inventiveness is deliberate or the result of a lack of economic understanding.

- **Reaching Financial Goals:** Businesses may use creative accounting to reach or surpass monetary objectives established by analysts, investors, or administration. The business's standing and value of its shares may be preserved or even increased as a result.

- **Bonuses and Incentive Payments:** Financial achievement criteria may be used to determine a manager's and staff member's remuneration. They can raise bonuses and other rewards by falsifying accounting records.
- **Avoiding Debt Covenant Violations:** Organisations in financial trouble may employ inventive accounting techniques to stay out of debt covenant violations, which may result in increased borrowing costs or default.
- **Tax Minimization:** By adjusting income, costs, and assets to lower income that is taxable, creative accounting may be utilised to minimise tax liability.
- **Window Dressing:** Businesses may use creative accounting to provide the impression that they are in a better financial situation than they actually are for creditors, investors, or other parties involved.
- **Access to Funds Markets:** Organisations can raise funds or get favourable terms from creditors by presenting an optimistic impression using altered financial accounts.
- **Market Expectations:** Businesses that are struggling to demonstrate consistent expansion or success may turn to innovative approaches to accounting in order to satisfy shareholders and prevent backlash.
- **Maintaining Share Price:** By inflating earnings per share (EPS) and share price deliberately, creative accounting can help management and current shareholders by giving them stock options.
- **Competitive Pressures:** Businesses may feel under pressure to use creative accounting techniques in order to stay competitive in sectors where financial performance is heavily monitored.

For whatever reason, since not everything that looks like a profit is actually a profit, creative accounting will perpetually be reflected in financial metrics and ultimately in the firm's solvency. The fact is that the corporation could still experience bankruptcy, insolvency, etc. even at the point of artificial exaggeration of its financial parameters.

Effects of Creative Accounting on Indian Financial Sector

The financial industry may be impacted by creative accounting in a number of ways, both positively and negatively. Among the consequences are:

- **Investor Misleading:** One of the worst consequences of imaginative accounting is the fact that it can give investors and other interested parties a false impression of the financial stability of a company. As a result, investing decisions may be made using inaccurate information.
- **Enhanced Risk:** When a company's underlying financial status is hidden by creative accounting, lenders and investors are exposed to greater risk

since they might not be aware of the true financial hazards to which they are exposed.

- **Market Distortions:** By artificially inflating or deflating the value of assets, creative accounting techniques can distort market prices and cause inefficiencies in the market.
- **Regulatory Concerns:** Regulators may be worried about the accuracy of financial reporting and the soundness of the banking system, which can lead to worries regarding creative accounting.
- **Loss of Trust:** Creative accounting practices have the potential to reduce investor and shareholder confidence in the accuracy of financial statements and the veracity of reported financial data.
- **Impact on Money Allocation:** Investors may decide to invest in less viable projects or businesses as a result of erroneous information, which can result in a misallocation of money.
- **Legal and Reputational Risks:** Businesses that use creative accounting may be vulnerable to legal and reputational issues if their methods are found out, which might result in lawsuits and harm to their brand.

In general, creative accounting can have negative repercussions on the financial sector, including higher risks, loss of confidence, and distorted markets. To preserve the reliability of the financial system, investors as well as regulators need to be on the lookout for and take action against such actions.

Techniques for Preventing Creative Accounting

For financial reporting to remain transparent and trustworthy, creative accounting—which is the manipulation of financial data to give a more favourable image of the financial health of an organisation than truly the case—must be avoided. Here are a few methods to avoid it:

- **Robust Corporate Governance:** Ensuring accurate and honest financial reporting can be achieved by the implementation of strong corporate governance procedures, including having a separate board of directors. Establish a culture of ethics within the company so that staff members are aware of the value of truthfulness and authenticity when it comes to fiscal reporting.
- **Internal Controls:** To stop and identify fraudulent activity, put in place robust internal procedures, such as job segregation, frequent audits, and comprehensive documentation. Information and Instruction: Educate staff members on ethical behaviour and requirements for financial reporting on a regular basis to assist them grasp the significance of correct reporting and the ramifications of creative accounting.

- **Safety for Whistle-Blowers:** Provide a framework, like an anonymous hotline or alerting system that allows staff members to bring attention to questionable activity without worrying about facing consequences.
- **Use of Technology:** Analyse accounting information for patterns of odd or fraudulent activity by using technologies like artificial intelligence and data analytics.
- **Openness:** Preserve openness in financial reporting by giving investors, regulators, and the general public clear and succinct information.
- **Independent Audits:** To verify adherence to financial disclosure requirements and spot any anomalies or inconsistencies, independent auditors should conduct routine independent audits.
- **Legislative Compliance:** To avoid fines and legal ramifications pertaining to financial reporting, keep abreast of the most recent legal regulations and adhere to them.
- **Moral Leadership:** Set a good example for the organisation by acting morally in financial situations. This will encourage everyone in the company to do the same.

Creative Accounting Practices in Indian Financial Sector

1. HDFC Bank has been reporting an operating profit that includes gains from the sale of securities. Roughly four percent of these gains in FY 2002 came from the selling of stocks.
2. ICICI Bank: In 2001, the financial institution saw a 55% decline in profit after writing off bad loans in the amount of Rs. 813 crores against the company's financial statement. In contrast, over the three years from 1997 to 1999, ICICI only wrote off Rs. 701 crore, which was deducted too from reserves. Before the ICICI Bank, there was an only once write-off in FY 2001.
3. In 1996, CRB Capital Market Ltd was a part of an accounting scheme. It was alleged that Mr. Roop Bhansali embezzled Rs 12 billion from the CRB (Chain Roop Bhansali scam). He said he was wrapping payment orders and repayment orders and was accused of utilising SBI accounts to syphon off bank funds. The Gujarat Government and UTI (Unit Trust of India) both suffered damages as a result of this scam.
4. Home Trade, a Gujarati corporation, caused a stir with its mishandled assets of Rs. 60 billion, resulting in a cumulative loss of Rs. 800 million for eight co-ops, including the South Gujarat-based Navsari Co-operative Bank and the Valsad People's Co-operative Bank, up until 2002. It was also connected to an EPF scheme run by the central government that involved a Rs 82 lakh forgery. In this instance, Mr. Sanjay Agarwal, the chairman, and Mr. Ketan Seth, the director, were taken into custody.

5. In 2003, Nagarjuna Finance Ltd was held accountable for a scam involving around one billion rupees. NFL's use of inventive accounting practices in the books of account and poor financial management resulted in a nearly Rs 1 billion loss to its depositors for the 1997–1998 fiscal year. Mr. KS Raju was the business's promoter. NFL has only Rs. 548 million left to be repaid as of December 2003.

Every stage involves engaging in financial activities, including the selective application and selection of accounting standards, both inside and beyond the parameters of widely recognised standards of accounting, as well as the fabrication of financial records. Steps taken for income smoothing and earnings management are also covered; these serve as the basis for businesses' use of creative accounting. notes that disclosure management and "creative accounting" are similar in that they both involve a strong involvement in the monetary record process.

Conclusion

Every phase participates in the financial game, which includes both false financial records and the hasty selection and implementation of accounting standards, both inside and outside the bounds of widely accepted accounting principles. Included are also measures taken for smoothing out income and revenue management, which serve as the basis for businesses' use of innovative accounting techniques notes that, insofar as it involves a strong engagement in the financial recording process, "creative accounting" is comparable to disclosure management. Political figures have an impact on accounting scandals in the Indian financial sector, which emerge when dependable administrators of big public corporations admit their mistakes. These offences typically involve complex techniques for financial mismanagement, such as inflating revenues, understating expenses, inflating the worth of the assets of the business, or concealing the existence of obligations with the assistance of colleagues or managers in other organisation. Although creative accounting techniques may adhere to the letter of regular accounting procedures' regulations, they unquestionably depart from their spirit. Excessive complexity, the use of creative language to describe income, assets, or liabilities, and the desire to sway readers' opinions are what define them. Commercial and public financial institutions have been using this kind of "creative accounting." The Securities and Exchange Board of India and the Central Bank of India are two government-recognized bodies that carry out inquiries into fraudulent activities and the improper use of funds. As we can see, compared to the software and banking sectors, there were a greater number of misunderstandings made by Indian financial sector enterprises engaged in acquisitions and financing.

Bibliography

- [1] Agustia, Dian, (2020). Earnings management, business strategy, and bankruptcy risk: Evidence from Indonesia. *Heliyon* 6: e03317
- [2] Browne, C. (2015), Creative accounting becoming more common for IPOs, available at www.valuewalk.com.
- [3] Goel, R. and Ansari, A.A. (2015), Abuse of creative accounting: a case study of satyam computer services ltd. *Research journal of commerce & behavioural science*, vol. 4, no. 3, jan, pp. 65-70.
- [4] Vyas, A.H., Ambadkar, R. and Bhargave, J. (2015), True and fair view: a fact or illusion in the world of creative accounting, *international journal of multidisciplinary and current research*, vol. 3 may/june, pp. 572-575.
- [5] Yadav, B. (2014), Creative Accounting: an empirical study from professional perspective, *International journal of management and social sciences research*, Vol. 3, no. 1 January, pp. 38-55.