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Creative Accounting practices and the reliability of Financial Statements
- Evidence from the most iconic financial scandals –

AKKOUCHE Mohamed Amine[1]
[1] Faculty of Economic, Commercial and Management Sciences, University of Algiers 3, Algeria
amineakk86@gmail.com

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Abstract

This study aims to shed light on *Creative Accounting* and its practices, motives, and its impact on the faithful image of an entity's financial position, and the reliability of the financial statements, as well as its relationship to fraud. This study also presented some examples of techniques used in manipulating accounting numbers, in addition to possible means to reduce the negative impact of creative accounting.

Keywords: creative accounting, earnings management, faithful image, financial statements.

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ملخص

تهدف هذه الدراسة إلى إلقاء الضوء على المحاسبة الإبداعية، ممارساتها، دوافعها وأثرها على الصورة الصادقة للمركز المالي للمنشأة، وموثوقية التقارير المالية، وكذلك علاقتها بالاحتيال. كما قدمت هذه الدراسة بعض الأمثلة على الأساليب المستخدمة في التلاعب بالأرقام المحاسبية، بالإضافة إلى الوسائل الممكنة لتقليل الأثر السلبي للمحاسبة الإبداعية.

الكلمات المفتاحية: المحاسبة الإبداعية، تسيير الأرباح، الصورة الصادقة، التقارير المالية.

* Corresponding Author

1. INTRODUCTION

Financial reports provide information about financial position and performance of a given entity and changes in that position. These reports are the result of an information system that collects, records, analyzes, classifies and summarizes the entities' financial data.

Stakeholders use financial information as an input in the decision-making process, and since the users of financial reports, whether they are external or internal, have their different decisions based on the information presented in the financial statements, the latter must honestly present the financial position of the entity, so that those users can make the right decisions towards that entity. This is only achieved if the financial reporting system is built and designed in a way that ensures that the financial information has been prepared in accordance with the relevant principles and methods, as well as in accordance with the professional legislation. However, due to the different goals and intentions of those who prepare the financial reports, this picture may be distorted by various manipulations and illegal actions that make the financial position and profitability of an entity look better or worse than it really is.

This kind of manipulation is not a new phenomenon in accounting, but it has a long history, as there has always been a desire to change accounting numbers by businessmen to give a desired impression about an entity. The ambition to make numbers more or less attractive goes back more than 500 years.

"*Luca Passioli*" mentioned creative accounting practices in his book "*De Arithmetica*", whereby the Venetian merchants in those times recorded the transactions between them by holding books under double entry principal with ink and quill pen in main and subsidiary books, and if any contradictions arise, sometimes they sweep the ink from these notebooks to make the entries unreadable. As the business environment has evolved and become complex over time, these practices also has evolved to become what is known today as "Creative Accounting" or "Earning management", it differs from fraudulent practices, as it remains under the applicable laws and legislation and does not violate it. Therefore, it is not illegal but unethical in terms of misleading investors.

The prevalence of creative accounting practices in the last two decades and its misuse has led to the collapse of a large number of prominent companies such as "*ENRON*" and "*WorldCom*", which has led to doubts about the effectiveness of corporate governance, reliability of financial reports, as well as the credibility of auditing work. In this context, the main question of our study is structured as follows:

What are the main causes and motives of creative accounting, and what are the most important techniques used in this contest, and can these practices be reduced?

We will try to answer this question by, first, providing an overview of what creative accounting is, how it works, and the various reasons that lead managers to resort to it, and then we will present the most important techniques used in manipulating the informative content of the financial statements, with some examples. After that, we will present the most iconic financial scandals related to creative accounting. Finally, we will suggest some methods that contribute to limiting the use of creative accounting negatively.

The research significance arose from the fact that it deals with a topic that touches the most important nerve in accounting field, which is the reliability of financial statements, and this by addressing creative accounting practices, its techniques and effects on the financial statements, and presenting possible means to reduce these practices.

2. What is Creative Accounting?

There are several definitions of creative accounting in the accounting literature, but they all fall under the same idea. It can be defined as “Any action from management that affects the reported income, which does not provide a real economic advantage to the entity and may in fact be detrimental in the long run” (Merchant, K.A. 1994, p.79), It can also be defined that it is “accounting practice that may (or may not) follow the accounting principles or standards, but deviate from what these principles or standards intend to achieve, in order to show a desired image of the company to the stakeholders” (Bhasin, M. L. 2016, p145). It is also defined as the process of "converting the financial accounting numbers from what they actually are to what the preparer desires by making use of the current rules or ignoring some or all of them." (Naser, K. 1993).

Through the above, we can give a comprehensive definition of creative accounting. It is the use of accounting knowledge to influence the reported numbers, and change the accounting information from what it reality is to what the management wants to inform the stakeholders, while remaining within the accounting rules and laws, by using options or gaps that exist in those rules and laws.

3. Motives for using creative accounting:

There are many reasons and motives for creative accounting, we may find it in all companies, the fact that the latter is subject to various forms of rights, obligations and contractual restrictions based on the amounts declared, and the existence of taxes based on income. Consequently, the managers may resort to the use of creative accounting that helps them to fulfill, avoid, or reduce these obligations; among the most important motives are the following:

3.1. Achieving internal goals:

Sometimes managers change the facts to achieve the internal goals set by the top management in relation to sales, profitability, and stock prices (Syed Zulfiqar Ali Shah, 2011, page 98). Where creative accounting helps in maintaining or increasing the price of shares by reducing the apparent level of debts, thus making the company appear less vulnerable by creating an impression that company is making good profits, as this helps it to increase capital from new shares issuance, and resist acquisition from other companies. Creative accounting may also be the result of a desire to obtain some tax advantage especially when taxable income is measured by accounting numbers.

3.2. Meet external expectations:

Company has to face many expectations from its stakeholders. The Employees and customers want long term survival of the company for their interests. Suppliers want assurance about the payment and long term relationships with the company. Company also wants to meat analyst’s forecasts and dividend payout pattern (Ibid). Thus the accounting policies in some companies may be designed, within the accounting rules, to match the declared profits with their previous expectations. Companies may also use income smoothing to show a steady income stream to impress investors and to keep stock prices stable. Proponents of this approach prefer using it rather than valuing an investment on the basis of immediate returns (in the short term), as a company with volatile results will be seen as more risky and give the impression that it is poorly managed. While a company with consistent results will provide a high degree of confidence to investors.

3.3. Special circumstances:

Companies may resort to creative accounting techniques under some special circumstances, such as:

- <u>Manage Gearing and Borrowing</u>: Companies often borrow money, for which loan contracts are concluded. Most of the times in these

contracts there are clauses that imply the stability of some economic and financial indicators or results that, once violated, bring the company into the situation of paying penalties or even immediately reimbursing the credit. By maintaining contractual parameters within the limits, using creative accounting when it is not otherwise possible, managers keep the company away from possible penalties or even more severe cases of economic destabilization caused by reimbursement of a loan before the deadline set by contract (Ciocan Claudia Cătălina, 2017, p 527).

- Window dressing for important events: This may be done before important events related to the institution, and when large transactions are expected in capital markets, such as, initial public offering (IPO), shares issuance, acquisitions, mergers, or before obtaining a loan, the company may resort to creative accounting to show its results better than they really are. The company's managers may also choose an accounting policy that increases the amount of declared profits, to distract attention from some undesirable news.
- Change in management: New managers may deliberately show losses due to poor management of their predecessors, as this trend was widespread among American bank managers, and thus managers may resort to creative accounting to make themselves look more efficient than their predecessors.
- Waiting for good times: There are situations in which the company may be in a critical financial situation, but it has better expectations for future periods, so it resorts to some creative accounting techniques in order to avoid announcing bad results while waiting for the situation to improve.
- Believing that current regulations are not correct: A fairly rare case is when the managers want to give a true and fair view, but believe that current regulations prevent this from happening. Thus, they believe that, by adopting a more liberal, more creative way of keeping the books, they will be able to deliver the fair view (Ibid).
- To get Government Assistance: when a company has to face foreign competition, it may need help from the Government of its country and the government will need to make sure that the company is indeed struggling to survive in the market. Therefore, instead of

moving up the profit, the company needs to lower its profit to strengthen the case of the company to get government assistance (Dr.Ruchi Gupta, 2018, p 240).

3.4. Personal reasons:

In some cases, managers' salaries and bonuses are conditional on achieving certain goals or results, which leads them to resort to these methods. Managers also look for job security. In this case, the question which rises, "why should I be at risk of losing my job if there is a possibility of arranging the results according to the investors' expectations?" Another reason has to do with human nature; it is in our nature to expect gratitude, honor and appreciation. Managers are also people, their self-esteem often prevents them from reporting the real situation of the company and exposing themselves to criticism and blame, therefore they may resort to creative accounting techniques (Jones, M.J. 2011, p 33, adapted).

4. How creative accounting works:

Creative accounting practices pass through two main sections in accounting:

- Misuse of Accounting Policies: Accounting standards and policies cannot cover every aspect of business transactions, so there is considerable freedom for companies to move within the legal loop, and therefore loopholes in the rules and laws in effect, can be exploited to manipulate the content of financial statements.
- Changes in Accounting Policy: Due to the latitude available in accounting policies, companies can alter their profit figures by changing the accounting policy and deliberately omit to mention the change of policy in notes or omit to give correct impact of the change. For example: changing the closing stock valuation method and do not inform the readers of the financial statements that what impact either positive or negative it could have on earnings. Change the rate of depreciation method or change the method itself to increase or decrease the depreciation expense (Syed Zulfiqar Ali Shah, 2011, page 99).

5. Creative accounting and the faithful image:

The debate about creative accounting and its impact on the faithful image has generated two major opinions (Gînţa Anca Ioana, 2018, p 601):

- The Anglo-Saxon opinion: which we find in countries in which we distinguish accounting from taxation and where the financial statements represent a synthesis of financial accounting and management accounting. In other words, accounting mirrors the economic reality and is perceived as an information system regarding the company and about the company. The opinion spread in these Anglo-Saxon countries is that the faithful image depends on the professional reasoning which is an expression of professional art. This method of presentation should lead to an image which does not suffer intended deformations, manipulation or omissions of significant information;
- The continental opinion: according to this opinion, in some countries the accounting was and still is perceived as a tool in the service of the state which has to assure a correct tax base for the calculation of taxes and duties. In order to reflect a faithful image, by the annual financial statements of reporting, the accounting has to be run based on own principles for exclusive fiscal purposes, without proceeding to misrepresentation by the adjustments made to the values.

Therefore, the view of creative accounting differs according to the two previous opinions. The first opinion sees it as a necessary practice to keep pace with developments in various fields, economic, legal and social, but it may have a negative impact on the faithful image if the flexibility allowed by accounting standards is used in order to report for the benefit of a few users of financial information to the detriment of the majority. As for the second opinion, it is believed that creative accounting constitutes an obstacle to achieving the faithful image, and it is a misleading and undesirable practice.

6. Creative accounting and fraud:

Creative accounting can turn into a criminal activity, and this type of creative accounting usually gets a lot of attention, due to the harm it causes to users of financial information, but sometimes it is difficult to clearly distinguish when creative accounting turns into illegal accounting (fraud), where "the rationality and objectivity of accounting is based on the level of rationality and objectivity of the person who interprets the accounting rules (D. Gerboth, 1987, pp. 1-8)." Thus, we can say that there is a thin line between use of positive creative accounting methods and actions that resemble fraud.

7. Creative Accounting Techniques:

There are many techniques and means used in manipulating accounting numbers, and they are mainly related to fixed assets, through addressing research and development costs, re-evaluation, depreciation policy and its amendments, and capitalizing subsequent costs. It is also related to current assets by evaluating stocks, the volume of stored production, and calculating and recording adjustments for stock consumption and its impairment. These techniques also touch equity through the manipulation of provisions; it is also related debts and receivables through the manipulation of sales or expenses. Below we will present examples, but not limited to, the most important techniques used:

7.1. Revenue recognition:

The declared income and its changes are among the main indicators related to the financial position of an entity. The timing of income recognition and fictitious sales are at the forefront of the tools used in manipulating income. It is common for many entities to book revenues even before they are recognized to increase profits, and sometimes companies do not want to show a profit above certain levels, so they defer revenues to reduce their profits. The timing of expense recognition is also used in the same way to achieve desired objectives, either to show increased or reduced profits. Income may also be recognized before sales are completed, or as soon as orders arrive, or fictitious income may be recognized that includes recognizing sales or deals that do not actually exist. That is why there is a wide debate on this issue among accounting policy makers, standard setters and companies about when to recognize and record revenues and expenses.

7.2. Income statement arrangement:

This practice involves reporting a different level of earning capacity using the income statement format, rather than the method that depends on how transactions are recorded. For example, companies may report non-recurring gains as recurring ones, or recurring expenses that may be classified as non-recurring. This will result in higher levels of recurring earnings without a change in total net income.

7.3. Inventory manipulation:

Inventory manipulation is either by manipulating the quantity of stock or by evaluating it, where in years when the enterprise needs to raise profits, the quantity can be manipulated through a particularly strict inventory procedure, as well as manipulating stocks through the provisions allocated to it, and changing valuation methods.

7.4. Materiality:

Companies using this practice attempt to argue that the impact on net income is too small to be significant. For example, some companies may not recognize expenditures below a certain limit as an asset, even its economic benefits are likely to be spread over several years, but lowering this limit can easily increase profits, while raising it may reduce it.

7.5. Big bath charges:

In this technique, instead of showing losses for a couple of years, a big loss is shown for a single year by charging all expenses in that year. This may be done if there are apparent reasons for poor profitability in that year and the management feels that by lumping all expenses in one bad year, they can start showing better profits in following years (Syed Zulfiqar Ali Shah, 2011, page 100).

7.6. Cookie Jar Reserves (provisions):

Over-provisioning for accrued expenses when revenues are high helps to bring down profits to a level that is safe to maintain in the future. Similarly, failure to provide all the accrued expenses can help show larger profits during tougher times when such is the need of the hour (Yasir Bin Tariq, 2011, p534).

7.7. Accounting estimates:

Some accounting records in some cases include an unavoidable degree of estimation, judgment and forecasting, such as the estimation of the useful life of an asset that is made for calculating depreciations. These estimates are usually made within the company and thus the accountant has an opportunity to manipulate these estimates.

7.8. Sales timing:

The timing of real transactions can also be used to give the desired impression in financial statements, for example, if the market value of a particular item exceeds its accounting value, then the company's managers are free to choose the year in which they sell that item and thus increase the profits.

8. Examples of creative accounting techniques:

Example 1: When the repairing costs (for example) of a factory wall are paid, these repairs are supposed to be recorded as an expense, because this payment does not improve the factory buildings value, but only restores them to their previous value. However, if these expenses are recorded in the debit side of buildings account, it will result in an increase in assets and a decrease in costs, which in turn will lead to an increase in the statement of net profit for the relevant year.

Example 2:

When costs are paid to build a new shed in a factory, this is considered a capital expenditure, because it increases the value of the factory buildings. However, if these expenses are recorded in the repair and maintenance account, it will lead to an increase in the expenses amount and a decrease in the value of assets. This, in turn, will result in lower net profit for the relevant year.

Example 3:

When the entity decides not to allocate any amortization to a specific fixed asset obtained during the year, for one reason or another, this means that the amortization will not be charged for this year, and will not be subtracted from the account of that item in assets, and therefore this will lead to an exaggeration of the net profit for this year, and an overstatement of assets in the balance sheet. And vice versa when the entity may decide to allocate amortization for an entire year to an asset that was purchased at the end of this particular year and used for a short period only, this means that the amortization burden will be exaggerated, and logically will be subtracted from the item account in the balance sheet, resulting in higher expenses being shown in the income statement and reduce the assets in the balance sheet.

Example 4:

When the entity receives an order to supply goods in the future, with an advance payment (prepayment), the amount received is considered as a liability (customers credit) until the entity actually delivers the goods. But if the entity decides to recognize that prepayment in sales account, this will lead to an overstatement of revenue in the income statement, and an understatement of liabilities in the balance sheet, and this increases profits.

Example 5:

Entities that are active in some industries that provide goods covered by some kind of warranty, such as computer software, cars manufacturers and

machinery…etc, often do not record all sales proceeds in the sales account, and they transfer part of it to provisions, to be credited against claims costs on guarantees and after-sales services in later years, but in fact they do not actually cover the costs related to those claims, but are recorded (costs) according to their normal nature, even if they relate to goods supplied in previous years. The entity can also reduce its result by allocating unnecessary or unjustified provisions, which means that part of the revenue was considered a liability (discount), that is, by reducing the sales account (revenue) in the income statement and raising the liabilities in the balance sheet, and this reduces the result.

9. Cases of creative accounting scandals:

We present in this section the most important financial scandals that have a relation with creative accounting practices, in one way or another. In deed in some of these cases there are also fraudulent practices which are different from creative accounting, as we explained before, but it always starts with creative accounting before it becomes a fraud. We present the first three cases (WM, ENRON and WorldCom) with details of the technics used in each company, but for the rest of cases we present it with a fewer details just to give a sight of each case's nature.

9.1. Waste Management Scandal (1998):

Waste Management Inc. is a publicly-traded US waste Management Company. In 1998, the company's new CEO, "Maurice Meyers" and his management team discovered that the company had reported over $1.7 billion in fake earnings.

The Securities and Exchange Commission (SEC) found the company's owner and former CEO, "Dean L Buntrock" guilty, along with several other top executives. In addition, the SEC fined Waste Management's auditors, Arthur Andersen, over $7 million. Waste Management eventually settled a shareholder class-action suit for $457 million.

To meet analysts and investor expectations, the company journalized several creative accounting transactions to eliminate and defer expenses for the current period. By decreasing the expenses on the income statement, the company is able to report a higher profit. To do this, the company used several fraudulent accounting techniques (Anne Diamond, 2019, chapter 9):

- <u>Avoided depreciation expenses</u>: Waste Management had a number of garbage trucks used in operations. To depreciate these trucks, the company's management needed to assign a salvage value to each truck and the truck's useful life. Assigning values to these is done by every company, but the values (estimates) must be reasonable. In the

case of Waste Management, the estimates for the salvage values were inflated and the useful lives were extended. This lowers the depreciation expense taken for these assets each period, this raising the net income. For any assets that did not have a salvage value, an arbitrary value was assigned to lower the depreciation expense.

- Failed to record landfill expenses: As Waste Management filled their landfills with waste, they needed to record the related expenses. This was not done to help keep expenses off of the income statement. They also neglected to record the expenses necessary to write off the costs of unsuccessful and abandoned landfill development projects.
- Established inflated environmental reserves (liabilities): By inflating the reserves in connection with acquisitions on the balance sheet, Waste Management was able to successful avoid recording unrelated operating expenses. This method is similar to booking an allowance for doubtful accounts and changing the estimates each period to reduce the overall reserve instead of expensing it out keeping the expenses off of the income statement.
- Capitalizing expenses: the company also improperly capitalized a variety of expenses. This allowed the company to avoid expensing the amounts in full in the period they were used and deferring the amounts to the balance sheet as assets. For example, if a company purchased small equipment that was an immaterial amount to the company, they should expense that equipment. By capitalizing the equipment, they are able to create an asset on the balance sheet that they can expense in small amounts over time instead of all at once.
- Income statement arrangement: one method the company used to try and maintain the stability of the fraud was to use an accounting manipulation known as “netting” or “geography.” The company allegedly used netting to reduce operating expenses and accumulated accounting misstatements from prior periods by offsetting them against unrelated gains in the sales and exchanges of assets. The “geography” entries moved large amounts of money between different line items on the income statement to make the financials look the way the company wanted to show them.

9.2. Enron Scandal (2001):

Enron Corporation was a US energy, commodities, and services company based out of Houston, Texas. In one of the most controversial accounting scandals in the past decade, it was discovered in 2001 that the company had been using accounting loopholes to hide billions of dollars of bad debt, while simultaneously inflating the company’s earnings. The

scandal resulted in shareholders losing over $74 billion as Enron's share price collapsed from around $90 to under $1 within a year.

An SEC investigation revealed that the company's CEO, "Jeff Skillings" and former CEO, "Ken Lay", had kept billions of dollars of debt off the company's balance sheet. In addition, they had pressured the company's auditing firm, Arthur Andersen, to ignore the issue.

The two were convicted, largely based on the testimony of former Enron employee, "Sherron Watkins". However, "Lay" died before serving time in prison. "Jeff Skillings" was sentenced to 24 years in prison. The scandal led to the bankruptcy of Enron and dissolution of Arthur Andersen. The essentials technics used by Enron are (Ibid):

Mark to Market Accounting: Mark to market accounting is a practice that is accepted under GAAP. The process values certain assets and liabilities at their fair value (or market value) instead of cost. This method of accounting is generally used with securities. The company can record the present value of future cash streams. Part of Skilling's idea to trade energy as a commodity involved how to account for this "intangible" source of revenues. He proposed using a variation of "mark to market" accounting. Skilling's idea allowed Enron to book future potential revenues on the day that the transaction occurred no matter how much or how little cash came in to the company (this goes against the revenue recognition principle where you book revenues when they are earned). This allowed Enron to book revenues at whatever the company wanted them to be by recording the present value of predicted future revenues. This subjective way to account for revenues left profits open to manipulation and overstatement.

Revenue recognition (Off balance sheet transaction)**:** To improve net profit and cash flows at year end, Enron "sells" a Nigerian energy barge to Merrill-Lynch. Enron and Merrill Lynch came to an agreement to "move" the title of three energy barges located off of the Nigerian coast to Merrill Lynch in 1999. Evidence in court surfaced that Enron promised that the assets would be bought back in six months by the company or another investor. Enron recorded a gain on this "sale" of $12 million. But if Enron had an agreement with Merrill Lynch to repurchase the assets, they could not call it a true sale.

Enron should have accounted for this transaction as a loan since Merrill Lynch never had full ownership of the assets and Enron would eventually give back the money. Treating this transaction as a sale allowed Enron to book a gain (increasing their net income) instead of a liability (which they should have recorded since this was more like a collateral loan). This is

referred to as an "off balance sheet transaction" since the amounts that should have been included as a liability on the balance sheet were moved "off of the balance sheet" and onto the income statement while keeping cash on the balance sheet. This raises Enron's net income (keeping the stock price up), improves cash flows, and holds the assets steady on the balance sheet (the asset of the barges is exchanged for cash). In 2004, four former executives for Merrill Lynch were found guilty of fraud and conspiracy. Merrill Lynch paid over $90 million in fines for the unethical behavior of those executives.

9.3. WorldCom Scandal (2002):

WorldCom was an American telecommunications company based out of Ashburn, Virginia. In 2002, just a year after the Enron scandal, it was discovered that WorldCom had inflated its assets by almost $11 billion, making it by far one of the largest accounting scandals ever.

The company had underreported line costs by capitalizing instead of expensing them and had inflated its revenues by making false entries. The scandal first came to light when the company's internal audit department found almost $3.8 billion in fraudulent accounts. The company's CEO "Bernie Ebbers" was sentenced to 25 years in prison for fraud, conspiracy, and filing false documents. The scandal resulted in over 30,000 job losses and over $180 billion in losses by investors. WorldCom used in this case two major techniques:

<u>Capitalizing expenses</u>:

The management perpetrated the fraud simply by transferring line costs – fees to telecom network providers for use of their transmission networks – into capital accounts. This transfer of line costs into capital accounts allowed WC to meet analysts' expectations and to appear efficient by keeping high operating margins. For instance, in 2001 WC showed about 58% gross margins versus ATT's 51%. Moreover, the classification of line costs into capital accounts boosted operating cash flow. The capitalized expenses were included in investment activities and not in operating cash flows. In sum, the financial statements portrayed WC as one of the leading firms in the industry, and as one of the most efficient (Gil Sadka, 2006, p457).

<u>Accrual liabilities</u>:

The end of each month, during the fraud period at WorldCom, was characterized by the estimation of costs that were associated with using the

phone lines of other companies. The actual bill for the services was usually not received for several months. This meant that some entries made to the payables could be overestimated or underestimated. In the case that the liability was overestimated, when the actual bill was received there would be a surplus of liabilities that when "released" would result in a reduction of the line costs (Ashraf, Javiriyah, 2011, p27).

WorldCom adjusted its accrual in three ways. Some accruals were released without even confirming if any accruals existed in the first place. Second, if WorldCom had accruals on its balance sheet it would not release them for the proper period and instead keep them as "rainy day" funds for future uses. Lastly, some of the accruals released were not even established for line costs (Dennis R. Beresford, 2003).

9.4. Tyco Scandal (2002):

Tyco International was an American blue-chip security systems company based out of Princeton, New Jersey. In 2002, it was discovered that CEO "Dennis Kozlowski", and CFO, "Mark Swartz", had stolen over $150 million from the company and had inflated the company's earnings by over $500 million in their reports. Kozlowski and Swartz had siphoned off money using unapproved loans and stock sales.

The scandal was discovered when the SEC and the office of the District Attorney of Manhattan carried out investigations related to certain questionable accounting practices by the company. Kozlowski and Swartz were both sentenced to 8 to 25 years in prison. A class-action suit forced them to pay $2.92 billion to investors(Corporate finance institute, 2022).

9.5. HealthSouth Scandal (2003):

HealthSouth Corporation is a top US publicly traded healthcare company based out of Birmingham, Alabama. In 2003, it was discovered that the company had inflated earnings by over $1.8 billion. The SEC had previously been investigating HealthSouth's CEO "Richard Scrushy" after he sold $75 million in stock a day before the company posted a huge loss. Although charged, Scrushy was acquitted of all 36 counts of accounting fraud. However, he was found guilty of bribing then Alabama Governor "Don Siegelman" and was sentenced to seven years in prison.

9.6. Freddie Mac Scandal (2003):

The Federal Home Loan Mortgage Corporation, also known as Freddie Mac, is a US federally-backed mortgage financing giant based out of Fairfax County, Virginia. In 2003, it was discovered that Freddie Mac had

misstated over $5 billion in earnings. COO "David Glenn", CEO "Leland Brendsel", former CFO "Vaughn Clarke", and former Senior Vice Presidents "Robert Dean" and "Nazir Dossani" had intentionally overstated earnings in the company's books. The scandal came to light due to an SEC investigation into Freddie Mac's accounting practices. Glenn, Clarke, and Brendsel were all fired and the company was fined $125 million (Ibid).

9.7. American International Group (AIG)(2005):

American International Group (AIG) is a US multinational insurance firm with over 88 million customers across 130 countries. In 2005, CEO "Hank Greenberg" was found guilty of stock price manipulation. The SEC's investigation into Greenberg revealed a massive accounting fraud of almost $4 billion.

It was found that the company had booked loans as revenue in its books and forced clients to use insurers with whom the company had pre-existing payoff agreements. The company had also asked stock traders to inflate the company's share price. AIG was forced to pay a $1.64 billion fine to the SEC. The company also paid $115 million to a pension fund in Louisiana and $725 million to three pension funds in Ohio.

9.8. Lehman Brothers Scandal (2008):

Lehman Brothers was a global financial services firm based out of New York City. It was one of the largest investment banks in the United States. During the 2008 financial crisis, it was discovered that the company had hidden over $50 billion in loans. These loans had been disguised as sales using accounting loopholes.

According to an SEC investigation, the company had sold toxic assets to banks in the Cayman Islands on a short-term basis. It was understood that Lehman Brothers would buy back these assets. This gave the impression that the company had $50 billion more in cash and $50 billion less in toxic assets. In the aftermath of the scandal, Lehman Brothers went bankrupt (Corporate finance institute, 2022).

9.9. Satyam Scandal (2009):

Satyam Computer Services was an Indian IT services and back-office accounting firm based out of Hyderabad, India. In 2009, it was discovered that the company had inflated revenue by $1.5 billion, marking one of the largest accounting scandals.

An investigation by India's Central Bureau of Investigation revealed that Founder and Chairman "Ramalinga Raju" had falsified revenues, margins, and cash balances. During the investigation, Raju admitted to the fraud in a

letter to the company's board of directors. Although Raju and his brother were charged with breach of trust, conspiracy, fraud, and falsification of records, they were released when the Central Bureau of Investigation failed to file charges on time.

10. Limiting creative accounting:

- Scope for choice of accounting methods can be reduced by reducing the number of permitted accounting methods or by specifying circumstances in which each method should be used. Requiring consistency of use of methods also helps here, since a company choosing a method which produces the desired picture in one year will then be forced to use the same method in future circumstances where the result may be less favorable (Oriol Amat, 1999, page 06).
- Misuse of estimates in accounting can be reduced by a simple rule that an initially determined accounting policy must be used in all future similar circumstances, which would minimize the use of estimates and achieve consistency. It is also important to highlight the role of internal and external auditors in identifying and reporting unfair estimates, and emphasize the responsibility of detecting and preventing accounting manipulations (Branka Remenarić, 2018, p 195).
- Scope for use of real transaction timing can be restricted by requiring regular revaluation of items in accounts so that gains or losses from permanent value changes are determined each year as they occur, rather than appearing in aggregate at the year in which the item is disposed of.
- Registration of fictitious transactions can be reduced by activating the principle of "substance over form".
- To limit these practices and enhance the integrity of financial reporting, the company's financial reports must be reviewed by an independent external auditor. In addition, the Board's Audit Committee, which is composed of independent members who are not executive directors, can play an effective role in preventing the misuse of creative accounting techniques and compliance with ethical standards in financial reporting. These members must also be changed from one accounting period to another;
- Establishing effective corporate governance controls, constantly educating employees about the professional code and ethics, and educating investors about the practice of manipulating financial information;
- creating accounting standardization bodies, competent bodies for arbitration and interpretation would also contribute to reducing creative accounting techniques (Carmen Vâlcu, 2019, p933).

- Giving great importance to education and continuing training of professional accountants and, as well as promoting the profession of accounting and judicial auditing.
- Applying conditional conservatism may reduce stakeholders' risks by ensuring correct information and by lowering the uncertainty that results from creative accounting. When any negative economic events occur, the value of both profits and net assets is reduced when using conditional conservatism (Hamed Amira, 2019, p 40).

11. Conclusion:

The improper use of creative accounting practices has deceived both auditors and regulators in the past, and continues to do the same, given the complex and diverse nature of business transactions and the extent of freedom available in accounting standards and policies, which makes it difficult to deal with the issue of creative accounting. Discovering its methods requires specialized and advanced knowledge from those who examine the financial information, and therefore there is little chance of it being discovered by investors, who often do not possess such knowledge. And unlike fraud, it only exploits the inaccuracy and incompleteness of accounting regulations, but this does not mean that it is ethical or a practice based on good faith to reflect reality honestly, on the contrary, most of the time it has the intention of fraud and misleading, although it involves many risks. However, it still attracts and tempts many managers in entities.

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