Creative Accounting and Accounting Scandals: Case Lets of Indian Companies

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ABSTRACT
Hearing of different scams is very common, but people who are associated with scammed companies are the ones who really got affected. Well not following accounting rules and regulation and deviating from those standards is a common practice which is known as creative accounting. Creative accounting is a root cause of all accounting scandals which give misrepresentation to various income statement and assets valuation. Some companies which do not follow the accounting rules and give a unfair and distorted information due to which users are misguided and take the wrong financial information. It is unethical to have undue use of power as companies tend to weaken the authority of accounting regulators and give unclear information to users. Here the term ‘creative accounting’ can be used actually which distorts reality but it is not unlawful to practice it without violating the rules. In this appear we have discussed the different techniques and motives associated with creative accounting and some Indian companies cases have been discussed those were indulged in accounting scandals. Therefore in last we concluded that the standards and regulations need to revise by keeping in mind without losing any scope of executing the misinterpretations and a watch shall be kept by the SEBI (Securities and Exchange Board of India), RBI (Reserve Bank of India) to avoid fraud.

Keywords---- Creative accounting, earning management, income smoothing, accounting principles, accounting scandals.
JEL Classifications: JEL M41, JEL M42, JEL M48

I. INTRODUCTION
In today time, hearing of different scams is very common, but people who are associated with scammed companies are the ones who really got affected. Well not following accounting rules and regulation and deviating from those standards is a common practice which is known as creative accounting. Creative accounting is a root cause of all accounting scandals which give misrepresentation to various income statement and assets valuation. Performance and status of a organization can be judge through financial statements to different stakeholders which varies from investors to employees to financial regulator or may be financial institutions etc. There are accounting rules, regulations and principles which is expected to follow by every company, so that companies can give a true, clear and fair picture because of which proper assessment and evaluation can be done and according appropriate decisions can be taken by the stakeholders. But there are still some companies which do not follow the accounting rules and give a unfair and distorted information due to which users are misguided and take the wrong financial information. It is unethical to have undue use of power as companies tend to weaken the authority of accounting regulators and give unclear information to users. Here the term ‘creative accounting’ can be used actually which distorts reality but it is not unlawful to practice it without violating the rules. Creative accounting is an accounting practice in which deviations can be made by finding various loopholes in the existing accounting rules and principles. Words like innovations and aggressive are used to substitute creative accounting in which misrepresentation of the true and fair income, liabilities and assets of corporations or organization is done.

Once Nobel Research Report stated that 50 good market cap size companies are into use of creative accounting practices and investors need to vigilantly observe and examine the books of accounts, its profits and cash flows. After the scam of Satyam, all the giant organizations which were directly or indirectly related with Satyam were into the circle of questions. We all know as India is a developing country and a major contribution is done by the corporate sector in economic growth or national income and it is also true that they get a lot of
opportunity for creative accounting as different countries have different accounting system which creates ambiguity and vagueness in the mind of investors'. It is because of loopholes in Indian Accounting standards and rules which helps Indian corporate sector to indulge in creative accounting practices and this is the reason which led to enhancing the accounting scandals.

II. LITERATURE REVIEW

Barthes de Reyter and Gilbert Gerald (1992) considered that the key objective of creative accounting is to evade the accounting rules that do not provide the desired image on the financial position and performance of the company. Colasse Bernard’s view (1992) undertakes the same idea, who think that creative accounting consists of ‘practices planned to give to the financial statements of a company the most pleasing picture possible’ and ‘the accounting information practices, often to the lawful limit, practiced by certain companies, taking advantage of the limits of regulation and normalization, which seek to adorn their financial position and financial and economic performances’. It was supported by Kamal Naser (1993) who mentioned that. Creative accounting foremost became very prevalent in 1980’s stated by Hussey & Ong (1996) who also mentioned that it is due to excuse and loopholes of accounting rules and regulations, companies could generate and create accounts which complement and enhance their financial performance. This study consider capitalizing interest, brand accounting, methods of depreciation, stock valuation and accounting standards which avoid the major maltreatment which used to occur and has issued a number of regulation in the form of Financial Reporting Standards. Standards setters should decide that making of accounting rules and standards should be such that there should be possibility of reduction of earning management. Healy & Wahlen (1999) said the financial reporting should illustrate and show a clear, true a fair picture and view of company but managers would manipulate the financial numbers than actual due to their personal interest like to enhance because of their personnel interest like to increase their management compensation, to provide low salary to employees and to pay fewer dividends to the shareholders. A short review is done by Balaciu, Bogdon & Vladu (2009) of creative accounting and its development to know what are the motives for creative accounting and what are the relative solutions and the study taken by them enable to correlate the creative accounting with different areas like bankruptcies, audit, governance, financial market, public sector and various articles to prevent creative accounting. it is not only one term creative accounting but also include different terms which can be available thorough review like creative accounting and earnings management practices have been referred to in the literature as income smoothing (DeFond and Park, 1997), window dressing (Teoh et al., 1998) and big bath accounting (Amat and Gowthorpe, 2004). There are also various parties who have their interest in creative accounting like auditors, regulators, researchers and investors because of the reality that their impact on reported earnings quality stated by Lee (2008). Vladu, A.B., & Mati, D. (2010) explained the matter of creative accounting and corporate governance in the perspective of internal demand for manipulative behavior which derives from the contracting value of earning management in the principal-agent relationship between shareholders and managers poor corporate governance causes manipulating accounting practices. Gherkin and Baldacci (2011) has illustrated accounting scandals like Enroc, Paramalat, WorldCom, Xerox, Hold Royal etc. Assurance and confidence in financial reporting has been diluted with occurrence of scams like Enron, WorldCom which shows manipulated statements and accounts. Those countries which are affected by bankruptcy crisis were supported to set new system and want to bring improvement in the old rules and regulation of accounting.

III. OBJECTIVE OF THE STUDY

1. To know the meaning of creative accounting with different techniques associated with it.
2. To know what are the motives behind creative accounting
3. To know in which sector the practice of creative accounting is used the most.

IV. MOTIVES BEHIND CREATIVE ACCOUNTING

The managers are motivated for setting up some changes in the form of manipulation either in the form of managing position or profits. In any organization, managers are aware that misstatement of profits can benefit by trading the securities. Therefore Insider trading is also exits this list of motives as stated by Beneish [2001]. There are three main aim as given by Stolowy and Breton [2000] for earnings management i.e. minimization of political costs, minimization of the cost of capital and maximization of managers’ wealth. Buyout case is also given by Deangelo [1988] in context of earnings management. Firms manage earnings prior to IPOs’ stated by Welch and Wong [1998] and Burgstahler and Eames [1998] mentioned that firms manage earnings to meet financial analyst forecast. Some concerns have been noticed and can consider the motives behind the accounting scandals:

a. Internal targets
b. External anticipation
c. Income smoothing
d. Window dressing
e. Taxation
f. Change in management

As the targets are set by the top management which need to be fulfill by all in an organization and because of unfulfillment of those the managers choose to manipulate the book of accounts in order to achieve the sales and profit. Now with respect to external parties, an organization has to face much hope and lot more expectations from its different stakeholders. For a common interest the employees and customers want a long term survival in the market. Company also wants to meet the forecast done by the analyst and dividend payout pattern. Even creditors /suppliers want assurance about their payment and long term association with the company. So an organization also needs to meet up with the expectation of all external stakeholders. A company wants to impress potential investors and maintain stability in the share price and for that purpose a smooth and evenly income stream is shown. The window dressing can be done before corporate events like IPO, acquisition or before taking a loan. For some tax benefit especially when taxable income is measured through accounting numbers misinterpretation is done. There is another important tendency of new managers to show losses due to poor management of old management by some provisions. All above mentioned are the reasons for occurrence of scams through accounting scandals.

V. TECHNIQUES USED IN CREATIVE ACCOUNTING

Flexibility in accounting standards: there is so much choice of rules and regulation of accounting standards like International Accounting Standards permits a choice between carrying noncurrent assets either at depreciated historical cost or revalued value. So, organizations prefer to change their accounting policies vary widely. There is deficiency in the accounting regulation like very few mandatory requirements are exists in case of accounting for stock options. Real and genuine transactions can be timed accordingly to give a desired impression in the accounts. For instance businesses have an investment at historical cost which can easily be sold for a higher sales price, being the current value. The managers are free to choose any year in which they sell their investment so that they can show enhanced profits in the accounts. Last but not the least fake or false transactions can be entered to manipulate balance sheet amounts and move profits between accounting periods. So we can say that flexibility in accounting regulations with its shortages or weaknesses, timings of transactions, manipulating of transactions with reclassification of financial numbers are some of the techniques used in creative accounting.

VI. CREATIVE ACCOUNTING WITH INDIAN CONTEXT

Creative accounting is at the root of a number of accounting scandals, and many proposals for accounting reform—usually centering on an updated analysis of capital and factors of production that would correctly reflect how value is added. Here in this paper, some case lets has been discussed, related to type of scam of different Indian companies with their impact.

Case Lets

CRB Capital Market Ltd involved in accounting scam in the year 1996. Mr. Roop Bhansali was accused of siphoning off Rs 12 billion in the CRB scam. He was accused of using SBI accounts to siphon off bank funds, claiming that he was encashing interest warrants and refund warrants. Due to this scam UTI (Unit Trust of India) and Gujarat Government also incurred losses.

ITC and the Chitalia group of companies were found to spoil FERA in the year 1996. The investigation was stared in June 1996 into export transactions between ITC and the Chitalia group of companies during 1990-95 and FERA violations were estimated at around $80 million. The Chitalia and several directors of the company including ITC Chairman KL Chugh were arrested but later released on bail. ITC in turn filled a suit on Chitalia for $15 million. Chitalias in turn sued ITC for $55 million, which they claimed ITC owed them.

Home Trade, a Gujarat based company made a fuss of poor investments of Rs. 60 billion which resulted a collective loss of Rs. 800 million of Eight co-operative banks, like Valsad People's Co-operative Bank and Navsari Co-operative Bank from South Gujarat till the year 2002. It was also linked to Rs 82 lakh forgery in a central government undertaking EPF scheme. Mr Sanjay Agarwal (chairman) and Mr Ketan Seth (director) were arrested in this case.

DSQ Software indulged in dubious acquisitions and biased allotments of Rs. 5950 million in the year 2000 & 2001. This case of accounting scam came into light in the year 2003. Mr. Dinesh Dalmia was chairman of DSQ and was arrested in the year 2006 and is currently serving jail sentence for violation of accounting practices and deception to its stakeholders.

Nagarjuna Finance Ltd was blamed in the year 2003 for a deception about Rs. 1 billion. NFL failed to return about Rs 1 billion to its depositors for the year 1997-98 due to lack of financial management and using of creative accounting techniques in the books of account. The promoter of the company was Mr. KS Raju. NFL could repay only Rs 548 million as at December 2003.

Satyam Computer Services chaired by Mr Ramalinga Raju, manipulated company’s accounts by showing overvalued revenues earned by Satyam Computer. This process of showing glorified profits led to a corporate scam of Rs. 70 billion. Mr. Ramalinga Raju confessed in...
the year 2009 that the company's accounts had been falsified. The global corporate community was shocked and scandalized when the chairman of Satyam, Mr. Ramalinga Raju resigned on 7 January 2009 and confessed that he had manipulated the accounts by Rs. 70 billion. Mr. Ramalinga Raju was arrested and is currently serving jail sentence for 7 years.

VII. CONCLUSION

Accounting scams are political and business scams which arise with the disclosure of misdeeds by trusted executives of large public corporations. Such misdeeds typically involve complex methods for misusing funds, overstating revenues, understating expenses, overstating the value of corporate assets or underreporting the existence of liabilities, sometimes with the cooperation of officials in other corporations or affiliates. Creative accounting means accounting practices that may follow the letter of the rules of standard accounting practices, but certainly deviate from the spirit of those rules. They are characterized by excessive complication and the use of novel ways of characterizing income, assets or liabilities and the intent to influence readers towards the interpretations desired by the authors. In public companies, this type of “creative accounting” can amount to fraud and investigations are typically launched by government oversight agencies, such as the SEBI (Securities and Exchange Board of India), RBI (Reserve Bank of India) in India. We can see that in Indian context those companies that were involved in investments and finance were doing more misinterpretations as compare to software or banking sector. Therefore, we can say the standards and regulations need to revise by keeping in mind without losing any scope of executing the misinterpretations.

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