Creative Accounting: Ethical Challenges Confronting External Auditors Behind the Cooking of the Books

Fe R. Ochotorena, DBA
Far Eastern University - Manila
Department of Accountancy
(fochotorena@feu.edu.ph)

Abstract **- This study provides insights into the attitudes of external auditors when they assess creative accounting including their ethical behavior and challenges towards these practices. This approach creates a new "kind of" accounting which is called in accounting practice, creative. It is creative mainly because the primary mission does not follow accountants or tax laws but mostly a "clever" idea of the owners or in other words "creative attitude" where the imagination plays a decisive role. Findings revealed that technically, creative accounting is not illegal. The change in accounting standards provides management multiple accounting methods that a company can choose from. Moreover, using creative accounting offers positive values and negative values to company's stakeholders. Creative accounting must not just benefit the company in the short-run but must also benefit the company in the long-run, which is what ultimately matters. The study concluded that a substantial proportion of all categories of companies employ creative accounting techniques to some extent. With the various accounting options and techniques available to financial statement preparers, creative accounting will always exist. In the end, creative accounting should be used if, and only if, it is within the ramifications of the law.**

Keywords **- cooking the books, creative accounting, deception, fraud**

I. INTRODUCTION

An entity has to meet many expectations from external parties. It has to face expectations of higher return from its stakeholders, the employees and customers expect long-term survival of the company for their own interest, and suppliers want assurance of their payments. Moreover, companies want to show steady income to keep their share prices stable and to impress the investors. All these urge the company to seek creative accounting practices. There is seemingly increasing pressure on the auditors' responsibilities due to expectation gap between auditors and the users of financial statements arising from accounting scandals (Onoja & Adaaja, 2015). The sorts of accounting irregularities that are often seen as creative accounting may be technically permitted but in general are frowned upon and often indicate fraud. The main objective of this study is to find out the ethical challenges confronting auditors upon discovery of creative accounting applied by their clients. Specifically, this paper sought to determine the views of external auditors about this manipulation of the financial statements. There has been substantial growth in the volume of literature discussing creative accounting issues and this phenomenon proliferates in accounting practices. It is a curious paradox that creativity is good in any profession but when it comes to accounting, it becomes bad being recognized as a synonym for deceptive accounting (Siddiqui, 2015). The concept of creative accounting which may be referred to as manipulative accounting, fraudulent accounting, window dressing accounting, and cosmetic accounting, has no generally accepted definition (Modum et al., 2014). Although today there is enough data on this issue, in accounting practices this phenomenon appears very often. Creative accounting is not exactly illegal, but on the other hand, it is not exactly widely promoted. In general, creative accounting capitalizes on loopholes in Generally Accepted Accounting Principles (GAAP) in order to disguise financial performance. A main component of accounting is financial statements, where the purpose is to present a fair representation of the company's financial standing. Although all managers and accountants must follow the generally accepted accounting principles when completing financial statements, there are perfectly legitimate techniques that can be employed when computing certain items. Managers and accountants can employ creative accounting to significantly skew their financial statements. Generally, creative accounting is an accounting practice that falls outside the regulation and gives benefit to certain people. It can be described as a practice with a clear aim to interrupt the financial reporting process which affects reported income to make it look normal and provides no true economic advantages to relevant parties like shareholders. It

refers to any accounting practice that is technically correct but deviates from how accounting policies were intended to be used. Thus, it refers to any financial practices which are imaginative and misleading but not necessarily illegal. Concisely, creative accounting is the transformation of financial accounting figures from what they actually are to what the management desires by taking advantage of the accounting policies which are permitted by accounting standards and/or ignoring some or all of them (Naser, 1993). Users of financial statements derive substantial confidence that the accounts give a true and fair view of the financial position of the firm from such auditor's opinion. Curiously, the auditors have continued to insist that the accounts actually present a true and fair view of the affairs of the entities audited and that they exercised both due care and professional diligence and skill in the conduct of the audits (Modum, 2014). The presence of illicit creative accounting in the composition of financial reports surfaced the purpose of this study. When fraudulent reporting occurs, it is frequently perpetrated at the levels of management. Nevertheless, company's external auditor plays a role to determine the extent of creative accounting use in the company. In short, although the ultimate responsibility for the prevention and detection of fraud and error rests with those charged with governance, auditors can still be held liable in the event that the financial statements are materially misstated. The principles of professional skepticism and due professional care are the two most important conventions that auditors should uphold. Professional skepticism is an attitude that includes a questioning mind and critical assessment of the audit evidence. The auditor should not accept every management assertion at face value; in saying that, he or she should not assume that management is dishonest, but the possibility of dishonesty must be considered. The due professional care principle requires the auditor to apply the care and skills expected of reasonably prudent and competent auditors. Auditors must possess the level of skills and they must exercise these skills with reasonable care and diligence. However, it should be taken into account that auditors have to work within limitations which include the inherent limitations of internal control, the fact that only sample testing can be done, time and cost factors, and the limitations of human resources. However, these limitations do not release them from the responsibility of uncovering material misstatements that would adversely affect the interests or decisions of the users of a financial statement (Mohd-Sanusi & Mat-Isa, 2007).

Definition of Creative Accounting

Creative accounting is the colorful representation of a company's assets, liabilities, and income. Desti (2014) cited that creative accounting means using the flexibility within accounting to manage the measurement and presentation of the accounts so that they serve the interests of preparers. With increasing hard economic times, companies may be motivated to practice creative accounting for diverse reasons. A typical aim of creative accounting is to inflate profit figures. It is basically done to attract investors. Some companies may also reduce reported profits in good years to smooth results. The term "window dressing" has similar meaning when applied to accounts, but is a broader term that can be applied to other areas. In the context of accounts, "window dressing" is more likely than "creative accounting" to imply illegal or fraudulent practices, but it needs to do so. Most creative accounting techniques change the main numbers shown in the financial statements, but make themselves evident elsewhere, most often in the notes to the accounts. The market has been surprised before by bad news hidden in the notes, so a diligent approach can give an edge. Typical creative accounting tricks include off-balance sheet financing, over-optimistic revenue recognition, and the use of exaggerated non-recurring items. Assets and liabilities may also be manipulated either to remain within limits such as debt covenants, or to hide problems. The use of fair value of the assets is another good example of this. For others, creative accounting is represented by the assembly of techniques, operations, and freedom spaces provided by the accounting texts which, without distancing from the accounting norm and strictness, allow the managers of an enterprise the change of the value of the result or the change of the aspect of the accounting documents (Gillet, quoted by Shabou & Boulila Taktak, 2002). Creative accounting is defined as a cumulus of accounting information practices, at the limit of legitimacy, practiced by some economic entities in order to beautify the image of the financial position and the economic-financial performances. Colasse (1996) also states the fact that these practices do not only arise as a result of the normalization limits but also as a result of the fact that the human creativity does not have limits (Colasse, quoted by Raybaud–Turillo & Teller, 1996). This approach creates a new "kind of" accounting which is called in accounting practices, creative. It is creative mainly because their primary mission does not follow accountants or tax laws but mostly a "clever" idea of the owners or in other words "creative attitude" where the imagination plays a decisive role (Kovanicová, 2005). It is the use of unorthodox "massage parlor" techniques which, while following provisions of GAAP, paint a desired (negative or positive, as the case may be) picture of a firm's finances. Indirectly, it is also called financial engineering or earnings management. Creative accounting, also called aggressive accounting, is the manipulation of financial numbers, usually within the letter of the law and accounting standards, but very much against their spirit and certainly not providing the "true and fair" view of a company that accounts are supposed to. The techniques of creative accounting change over time. As accounting standards change, the techniques that will work also change. Many changes in accounting standards are meant to block particular ways of manipulating accounts, which means that intent on creative accounting needs to find new ways of doing things. At the same time, other, well intentioned, changes in accounting standards open up new opportunities for creative accounting (http://www.moneyterms.co.uk/creative-accounting, 2016). The various methods of creative accounting can be considered to fall in four categories. (1) Sometimes, the accounting rules allow a company to choose between different accounting methods. A company can therefore choose the accounting policy that gives their preferred image. (2) Certain entries in the accounts involve an unavoidable degree of estimation, judgement, and prediction. In this case, the creative accountant can manipulate the valuation both by the way in which the valuer is briefed and by choosing a valuer known to take a pessimistic or an optimistic view, as the accountant prefers. (3) Artificial transactions can be entered into both to manipulate balance sheet amounts and to move profits between accounting periods. (4) Genuine transactions can also be timed so as to give the desired impression in the accounts. The timing of genuine transactions is clearly a matter for the discretion of management (Amat et al., 1999). Creative accounting is: a) the process through which, due to the existence of some breaches in the rules, accounting figures are manipulated and, taking advantage of the flexibility, they choose those measurement practices allowing the transformation of the synthesis documents from what they are supposed to be into what the managers want; b) the process through which the transactions are structured in such a manner that it allows the "production" of the "desired accounting result." Some authors define creative accounting as "an assembly of procedures having in view the change of the level of the result in order to increase or decrease, or present the financial statements, without these objectives being reciprocally excluded" (Stolowy & Breton, 2003). Creative accounting is presented as a legitimate fraud. From practitioner's perspective, Jameson (1988) appreciates the fact that accounting process in its essence, requires the operation with different motivations, different ideas. From this diversity arise manipulation, cheating, and falsification at some less scrupulous accounting members. It is he who states that these creative accounting practices do not break the law or the accounting standards; therefore, they comply with the law but not its spirit. Thus, the negative character of creative accounting distorts the enterprise's financial results and position which misleads the users of accounting information (Jameson, 1988).

Approaches of Creative Accounting

The accounting standards are created and implemented in order to standardize the accounting practices which contain definitions of the accounting concepts whose function is to guide the professional reasoning. The professional reasoning has a major impact on the creation of the financial statements because the subjectivity and the freedom of action can lead to the manipulation of the profits (Hronsky & Houghton, 2001). In a study by Gramlich et al., (2001), they suggested that firms may engage in balance sheet manipulation to reclassify liabilities in order to smoothen reported liquidity and leverage ratios. A special type of creative accounting relates to the presentation of financial numbers, based on cognitive reference points. On the other hand, Largay (2002) mentioned the potential for creative accounting is found in six principal areas: regulatory flexibility; a dearth of regulation; a scope for managerial judgement in respect of assumptions about the future; the timing of some transactions; the use of artificial transactions; and the reclassification and presentation of financial numbers. As to regulatory flexibility, accounting regulation often permits a choice of policy; for example, in respect of asset valuation, International Accounting Standards permit a choice between carrying non-current assets at either re-valued amounts or depreciated historical cost. Business entities may, quite validly, change their accounting policies. As Schipper (1989) points out, such changes may be relatively easy to identify in the year of change, but are much less readily discernible thereafter. For dearth of regulation, some areas are simply not fully regulated. For example, there are (as yet) very few mandatory requirements in respect of accounting for stock options. In the majority of countries, like Spain for example,

accounting regulation in some areas is limited such as the recognition and measurement of pension liabilities and certain aspects of accounting for financial instruments. With respect to the third area, management has considerable scope for estimation in discretionary areas. McNichols and Wilson (1988), for example, examine the discretionary and nondiscretionary elements of the bad debts provision. Moreover, for the fourth area, genuine transactions can also be timed so as to give the desired impression in the accounts. As an example, suppose a business has an investment at historic cost which can easily be sold for a higher sales price, being the current value, the managers of the business are free to choose in which year they sell the investment and so increase the profit in the accounts. For the fifth area, artificial transactions can be entered into both to manipulate balance sheet amounts and to move profits between accounting periods. This is achieved by entering into two or more related transactions with an obliging third party, normally a bank. For example, supposing an arrangement is made to sell an asset to a bank then lease that asset back for the rest of its useful life, the sale price under such a 'sale and leaseback' can be pitched above or below the current value of the asset because the difference can be compensated for by increased or reduced rentals. And lastly is the reclassification and presentation of financial numbers.

Moreover, Amat et al., (1999) perceived that various methods of creative accounting can be considered to fall in four categories. First, there can be different accounting methods to choose from. In the case of research and development expenditures, for example, a company may be allowed to write them off as they occur or amortize them over the life of the related project. Chances are, such company will choose the accounting method that will result in their preferred image. Second, some entries in accounting involve an unavoidable degree of estimation, judgment, and prediction. In some cases for example, in estimating life of an asset for calculating depreciation, the estimates are normally made inside the business and the creative accountant has the opportunity to err on the side of caution or optimum in deciding on the estimates. Third, artificial transactions can be entered for the purpose of manipulating balance sheets amount and increasing profits between accounting periods, which is achieved by two or more related transactions with an obliging third party, normally a bank. Fourth, genuine transactions can also be timed so as to give the desired impressions in accounts.

The following are the methods which can be used to tackle each of these approaches by accounting regulations who wish to curb creative accounting: (a) choice of accounting methods can be reduced by reducing the number of permitted accounting methods or by specifying the circumstances in which each method can be used; (b) abuse of judgment can be curbed in two ways. One is to draft the rules that minimize the use of judgment and second is apply “consistency” so that if one country applies one method which suits in one year also applies the same in unfavorable year; (c) artificial transactions can be tackled by invoking the concept of substance over form where by accounting substance determines by economic substance rather than legal form of transactions; and (d) the timing of genuine transactions is clearly a matter for the discretion of management. However, the scope to use this can be limited by requiring regular regulations of items in the accounts so that gains or losses on value changes are identified in the accounts each year as they occur, rather than only appearing in total in the year that a disposal occurs. Also, Schilit (1997) reported the case of one company accountant confronted with such an issue. His employer, a food wholesaler, incurred substantial costs in paying retailers who put new lines on their shelves. This is a common practice, known as 'slotting', and the costs are commonly written off in the year they are incurred. In order to keep within accounting ratios under loan agreements the company president proposed to capitalize the slotting costs and amortize them over ten years. The accountant undertook some research on other company practices, and as a result was confirmed in the view that this was not an acceptable accounting treatment. After, he identified cost savings that would have just kept the company inside its loan agreement and alerted the auditors to the issue, hoping that they would play the role of bad cop and force the company to expense the 'slotting'. The principal investor in the company tried, unsuccessfully, to put pressure on the auditor to support the capitalization of the slotting costs. Shortly after, the accountant was sacked for taking this stand. The series of actions in this case are revealing, that the proposed accounting method is in fact unacceptable. Furthermore, Dechow and Skinner (2000) stated that even if financial statements provide sufficient information to permit users to adjust for creative accounting, there would still be cause for concern over the value of the information content because of 'the possibility that certain investors rely completely on earnings numbers reported on the face of the income statement because their ability to process more sophisticated information is limited.' The results of these researches show that some elements of overt creative accounting practices are common.

Auditors' Responsibility

The role of auditors has not been well defined from inception (Alleyne & Howard, 2005). Porter (1997) reviews the historical development of the auditors 'duty to detect and report fraud' over the centuries. Her study shows that there is an evaluation of auditing practices and shift in auditing paradigm through a number of stages. Porter (1997) study reveals that the primary objective of an audit in the pre-1920's phase was to uncover fraud. However, by the 1930's the primary objective of an audit has changed to verification of accounts. This is most likely due to the increase in size. and volume of companies' transactions which in turn made it unlikely that auditors could examine all transactions. During this period, the auditing profession began to claim that the responsibilities of fraud detection rested with the management. In addition, management should also have implemented appropriate internal control systems to prevent fraud in their companies.

Ethics of Accountants

Yadav (2013) quoted that creative accounting is a challenge for the accounting profession. In practice, the situation in which under the pressures of the management, the accounting professional applies accounting treatments provided by the laws and regulations which show different image of the organization than true and fair one, which are countless. The accounting professional is forced to balance ethics, accounting principles, and their job. Creative accounting is not a fraud but it takes the benefits of loopholes in the accounting standards and regulations. It cannot be said fraud because it works within the framework of law. It takes advantage of multiple options available in accounting standards to show the transactions like different methods of depreciation and estimating useful life of the assets, different options available in revenue recognition as well as loss recognition, different methods available in valuing stock, and various acceptable methods for valuation of inventory. Managers often use that method which increases their benefits in that year and shows higher profit. However, auditor's attitudes towards creative accounting were not associated with the existence of these factors and in the last point, the research model finds negative relationship between experience and auditors attitudes towards creative accounting, indicating that the more experienced an auditor is, the less likely it is that he or she will agree with management's creative accounting choices. With respect to ethics in accounting and creativity, Uşurelu et al. (2010) stated that ethics should be followed by an accountant and creative accounting is a big challenge for them. This was in the context of National Code of Ethics for Professional Accountants in Romania. Referring to the same Code, it is divided into three parts. Part A establishes the fundamental principles of professional ethics for professional accountants and also provides conceptual framework for applying these principles. Part B and Part C illustrate how the conceptual framework should be applied in specific situations where Part A is not applicable. Profession objectives are established to meet the highest levels of performance and the public interest. Achieving these goals involves meeting four basic requirements: (1) credibility, throughout society there is need for credibility in information and information systems; (2) professionalism, should be clearly identified by customers, employers, and other stakeholders on accounting professionals; (3) service quality, it requires ensuring that all services obtained from the professional accountant are carried to the highest standard of performance; and (4) confidence, professional accountants' service users must be able to feel confident that there is a framework of professional ethics governing the provision of these activities since creative accounting can be synonymous with deceptive accounting. Furthermore, ethical behavior of a person in accounting depends on: (a) moral sensitivity, which could be described as how the subject comprehends the ethical dimensions of a situation. In accounting, one can feel that a practice can affect some people adversely or favorably. But there are also some sentiments of greed, self-sufficiency than those related to good behavior; (b) moral judgment, moral judgment or capacity to judge which alternatives are ethically acceptable and which are not. In accounting, objectivity, open mindedness, insight, and perspicacity can be considered as integrated within practical wisdom; (c) moral motivation, understood as willingness to take the moral course of action, placing moral values above the other values and taking personal responsibility for moral outcomes. It plays a crucial role in selecting the right action and in executing it; (d) moral virtues or permanent attitudes and interior strength formal behavior, among these virtues, those which have special relevance to accounting are truthfulness, honesty, loyalty, trustworthiness, fairness, integrity, service to the common good, gratitude, and benevolence. Courage, perseverance, competence, and diligence will also help the professional defeat inner resistance to act as one should in the same way

that practical wisdom will provide capacity to perceive the right means for each virtue.

Divergent Goals of Stakeholders

From the point of view in the life of an entity, Feleaga (2006) identified two categories of actors having a special position. On one side, the shareholders, who have rights after the creditors, suppliers, employees, among others. They take the financial risk justifying the appropriation on a part of the year's profit and from the case of the entity closing down. On the other side, the leaders because they have privileged information, taking into account the position held in the enterprise, are tempted to take advantage by allowing themselves considerable advantages or generally by, directing the entity towards a direction which is useful for them. The conflict of interest among different interest group is the real cause of creative accounting. Managing shareholders interest is to pay less tax and dividends. Investor-shareholder wants to get more dividend and capital gains. Tax authorities like to collect more and more taxes. Employees want to get better salary and higher share in profit. But creative accounting puts one group or two groups to advantageous position at the expense of others. He stated that creative accounting was defined as a process through which the accounting professionals use their knowledge in order to manipulate the figures contained in the annual accounts. Although there are misunderstandings regarding the definition of creative accounting, the majority of researchers accept the idea that this stands out through two aspects. The first aspect has in view the use of the accounting professionals' imagination in order to translate those juridical, economic, and financial innovations for which there are no normalized accounting solutions at the time of their occurrence. The second aspect shows the fact that the adjustments resulting from this financial engineering are initiated according to their incidence on the enterprise's balance sheet and results. Moldovan et al. (2010) focused on how information provided by accounting affects external users, and mainly on how and why distorted information gets outside of the organization into the hands of unsuspecting users. It was also explained that there is an inverse causal relationship between true and fair view principal and creative accounting. "True" and "fair" cannot be defined easily. Definition given by some authors to this concept, first "true" and "fair", neither of which are easy to define and secondly there are those who explain true and fair view in terms of "generally accepted accounting principles rather than accepting the concept as an independent quality." True and fair view through financial report's respect both word of law and its spirit. It is acknowledged that true and fair view expresses the responsibility of company management and auditors to show the correct financial position of the company.

Creative Accounting Motives

Shah et al. (2011) tried to give answer on why managers do creative accounting and how they become successful in performing such practices in the presence of stringent rules and procedures. They also tried to explore whether creative accounting practice is good or bring crisis in the companies and link of corporate governance with creative accounting. Many world examples were given like Enron which showed higher profit than actual and then collapsed. The role of corporate governance can play a vital role to reduce the risks of investors and show true and fair view of financial reporting. There are some choices in current accounting rules under international accounting standards and U.S. GAAP that allow managers some choice in determining methods of measurement and criteria for recognition of various financial reporting elements. Financial report should be audited by an independent auditor to reduce the information risk and to enhance perceived integrity. The audit committee of the board comprising of independent non-executive role, prevents the misuse of creative accounting techniques and observance of ethical standards in financial reporting. It was explained that it is not that creative accounting solutions are always wrong. It is the intent and the magnitude of the disclosure which determine its true nature and justification. On the other hand, Healy and Wahlen (1999) described about how standard setters should decide or make accounting standards to reduce the possibility of earnings management. Information about the company is provided by the financial reporting which should show the true and fair view of company but managers manipulate the financial numbers than actual due to their personnel interest like to increase their management compensation, to provide low salary to employees, and to pay less dividends to the shareholders. Standards add value if they enable financial statements to show difference between the relevance and reliability of accounting information under alternative standards. Similarly, Amat et al. (1999) cited that the reasons for creative accounting for the directors of listed companies to manipulate the accountants are as follows: (1) income smoothing, company prefers to show steady growth in profit rather than fluctuating high or low. So companies charge provision for liabilities against assets to reduce profits in good year; (2) a variant on income smoothing is to manipulate profit to tie in to forecasts; (3) company directors may keep an income-boosting alternative in hand to avoid unfavorable news; (4) creative accounting may help maintain or boost the share price both by reducing the apparent levels of borrowing, so making the company appear subject to less risk by creating the appearance of a good profit trend. This helps the company to raise capital from new share issues, offer their own shares in takeover bids, and resist takeover by other company; and (5) managers can use creative accounting to delay release of information for the market, thereby enhancing their opportunity to benefit from inside knowledge if the directors engage in "insider dealing" in their company.

Even though there are numerous articles and studies regarding the theme of creative accounting, there are still areas not yet covered by the existing literature which are worth studying. The issue dealing with ethical challenges confronting external auditors is underexplored. Being aware of the limitations of my research, I concentrated my efforts on a more deepened analysis of the famous cases of creative accounting in order to distort the real image of the entity's financial statements. In the end of my research, I retained the attention to investigate the ways on how external auditors respond and tackle the ethical challenges when they assess creative accounting practices.

To achieve the main objective of this study, the researcher tried to broaden the discussion on the various aspects of creative accounting taking into account ethical concerns encountered by external auditors. Specifically, this study aimed to answer the following research questions:

1. What are the commonly-used creative techniques to deliberately distort the financial statements?
2. What are the benefits and drawbacks of creative accounting?
3. How do external auditors view the practice of creative accounting?
4. How do auditors tackle the challenges brought by the discovery of creative accounting practices?

II. RESEARCH METHOD

Questionnaire surveys of auditors' views on creative accounting have been conducted among the respondents which include 50 senior auditors from the "Big Four" auditing firms during the year 2017. These senior practitioners are those who are involved in financial audit and have experienced substantial proportion of all categories of companies which employ creative accounting techniques to some extent. The present research made use of quantitative and qualitative research approach and employed a descriptive research design. The data collected have been obtained through the documentary study, questionnaire and interviews. The research strategy adopted in this study is survey research methodology using questionnaire. Using judgement sampling technique, the questionnaires were distributed to these professionals.

III. RESULTS AND DISCUSSION

Table 1.
Creative Accounting Practices

	Creative Accounting Approaches	WM	Rank
1	Window Dressing	1.65	10
2	Fabricate synthetic/artificial transactions	1.35	11
3	Sale-Lease-back	2.40	4
4	Revaluation of tangible asset	2.30	5
5	Application of different depreciation method, life, and residual value	2.45	3
6	Over-estimation of inventory	1.95	8
7	Under estimation of inventory	2.05	7
8	Increase or decrease in provision	2.80	2
9	Reducing the apparent levels of borrowing	1.80	9
10	Reclassification of accounts	3.75	1
11	Manipulate the timing of transactions	2.15	6

Reclassification of accounts, which is the transfer of an amount from one general ledger *account* to another, is the most common method utilized by companies probably because it is difficult to trace directly due to the loopholes in the accounting standards.

Table 2.
Pros of Creative Accounting Practices

	Pros of Creative Accounting	WM	Rank
1	Help enhance management performance	3.22	6
2	Meet internal targets set up by higher management	3.78	2
3	Boost reported profits or minimize reported loss	3.69	3
4	Form the base of tax management	3.63	4
5	Help conceal financial risk	3.59	5
6	Higher returns on their Investments	3.09	7
7	Increase in Bonus and Incentives	3.81	1

Incentives and bonus drive managerial actions to adopt creative accounting. Seemingly, management applies flexibility in the rules to their own advantage. This manipulative technique is used to artificially enhance the year's earnings in order to fulfill the management's selfish motives.

Table 3.
Cons of Creative Accounting Practices

	Cons of Creative Accounting	WM	Rank
1	Misrepresent and mislead the stakeholders	4.38	1
2	Practice is not being handled prudently	4.22	2
3	Disregard ethical consideration	4.38	1
4	Out of limits of accounting standards	4.06	4
5	Lead to uncontrollable situations imposing a threat to the very existence of the company	4.16	3
6	Distort the financial results and position	4.16	3
7	Abuse of judgment	4.22	2

"Disregard ethical consideration" and "misrepresent and mislead the stakeholders", appear to be the drawbacks of creative accounting. This result simply means that auditors view creative accounting as a way of cheating the interested parties. Sometimes, management resort to such practices which are totally unethical and out of the limits of accounting standards.

Table 4.
Reasons for Supporting and Opposing Creative Accounting

	A. Reasons for Supporting Creative Accounting	F	%
1	It is technically a legal accounting practice	4	3
2	It can be supported by disclosure	4	3
3	It is within the boundaries of acceptable alternative basis of accounting	5	4
4	It is legitimate and justified as long as it is not abused	4	3
5	Being innovative and creative is good in any profession	5	4
6	Competence is more important than ethics	0	0
	B. Reasons for Opposing Creative Accounting	F	%
7	It is classified as fraud	18	12
8	It is against the CPA's Code of Ethics	22	15
9	It adversely affects the interest of stakeholders	20	14
10	It leads to misrepresentation and falsification of financial statements	23	16
11	It exposes the auditors to legal consequences	19	13
12	It overrides the rules of standard accounting practices	19	13

Results show the opposing views of auditors about creative accounting. Majority of the respondents refute creative accounting since this leads to misrepresentation and falsification of financial statements. This result signifies that auditors value reliability in assessing the quality of financial information. In contrast, the advocates of creative accounting believe that innovation and creativity are good for the profession for as long as they are within the boundaries of acceptable alternative basis of accounting.

Table 5.
Ways to Handle Detection of Creative Accounting Practices

	Ways	WM	Rank
1	Substantiate through magnitude of disclosures	4.00	2
2	Express an adverse audit opinion	3.16	5
3	Express a qualified audit opinion	3.28	4
4	Express a disclaimer of opinion		
5	Express an unqualified audit opinion after evaluating the relevance and reliability of the financial reports	3.50	3
6	Apply substance over form	4.16	1
7	Compare the approach with the prescribed accounting standards or any alternative basis of agreed accounting	4.16	1
8	Charging a reasonable fee in exchange for inappropriate findings	2.12	6

Findings reveal that majority of auditor-respondents handle the detection of creative accounting practice by "applying substance over form" and "comparing the approach with the prescribed accounting standards" as both represented by the highest weighted mean of 4.16 (Agree). It is followed by substantiating the audit findings with magnitude of disclosures as represented by a weighted mean of 4.00 (Agree). This result denotes that auditors play an important role in promoting creative accounting practice in such a way that will not negatively affect the reliability of financial reporting. The foregoing results were supported by the interview of the senior auditors indicating that such audit finding is usually elevated to a more experienced professional of the engagement team or firm and assessed if the attention of the client's upper management is needed to be called. Entity's risk management and those involved with governance are also consulted to discuss the possible huge exposure risk to the entity. In case this cannot be settled, the matter will be included in the management representation letter, or worse this will result in withdrawal from the engagement, if necessary.

IV. CONCLUSIONS

Although all accountants and managers of business entities should follow the Generally Accepted Accounting Principles (GAAP) when preparing and presenting financial statements, there are perfectly legitimate techniques that companies can employ when computing certain items to manipulate their financial results. It is the transformation of accounting figures from what they actually are to what preparers desire by taking advantage of existing rules and/or ignoring some or all rules. The techniques of creative accounting change over time. As accounting standards change, the techniques that will work also change. Many changes in accounting standards are meant to block particular ways of manipulating accounts, which means those who intend to do creative accounting need to find new ways of doing things. However, the changes in accounting standards also open up new opportunities for creative accounting. And creative accounting capitalizes on loopholes in the accounting standards to falsely portray a better image of the company. The researcher realized that most creative accounting techniques change the main numbers shown in the financial statements, but make themselves evident elsewhere, most often

hidden in the notes to the accounts. Creative accounting may involve different aspects – management judgement, regulatory flexibility, inadequacy of the regulation, timing of transactions, artificial transactions, as well as reclassification and presentation of accounts. One of the reasons why a clear-cut line cannot be drawn on the ethics of creative accounting is that managers and accountants must estimate certain figures in accounting. Not all the numbers are known to the exact decimal place and some numbers are not even known close to the "real" amount, so financial statement preparers must use their best judgment in these cases. Technically, this is not illegal because they are within their rights to estimate the numbers, but it could fall into an unethical area if the true values are grossly misrepresented. Accounting standards often allow different choices of policy such as revaluation model or cost model for valuation of non-current assets. It is extremely difficult to draw an ethical line on creative accounting when the GAAP often allow multiple accounting methods that a company can choose from when calculating certain items. Also, the deficiency and existence of loopholes in some mandatory requirements contribute to a great deal of flexibility. When applying certain methods, the companies are going to choose the ones that make their financial statements look better. This is the nature of business – to make the company succeed as much as possible. Creative accounting assists in this endeavor. Moreover, due to the many types of businesses in the economy and with all of the different sizes and nature of transactions, it is extremely difficult because there is no single accounting method for all companies to use, and therefore, multiple accounting methods exist for companies to choose from. Thus, the company has not broken any laws, nor has overstepped any boundaries. The timing of genuine transactions and existence of classificatory smoothing are clearly at the discretion of the management in order to give a good impression on the accounts. On the other hand, from an ethical perspective, financial statement manipulations can be regarded as morally unacceptable. They are not fair to users as they involve an unjust exercise of power and they tend to weaken the authority of the regulators. In this context, external auditors generally regard creative accounting as ethically questionable. Moreover, they view that creative accounting has positive effect if it enhances the development of accounting practices and negative effect when it is meant to mislead and defraud investors, creditors, bankers, and other users of financial statements. Managers should take the primary responsibility for the financial statements of the company. However, both the auditors and the managers have some ethics to the society not to show the manipulated figures but to show the true and fair view of the company. Auditors should provide good information to shareholders, check all the transactions, and investigate any suspicious account or dubious transaction. They should provide quality and competent service to their stakeholders. They should ensure that creative accounting techniques should be undertaken without deceitful intensions to misrepresent and mislead the society. Auditors are expected not only to serve their clients but also to meet their responsibilities and duty of care to other stakeholders. Ethical judgment is fundamental to auditors in forming opinion whether financial statements fairly present the financial position, result of operations, and cash flows of an entity. Auditor's ethical judgment is formed by the provisions of the Code, organizational policies governing ethics, and an individual's own moral actions. Therefore, in the event that there is a breach of duty of care, stakeholders may sue the auditors for negligence. Although the basic responsibility of external auditors is to verify whether the financial statements exhibit a true and fair view of the state of affairs of the business and that prevention and detection of errors or fraud are just secondary, they are required to offer appropriate and concrete measures to tackle and arrest undesirable practices once uncovered. Confronted with ethical issues which include conflict of interest and client proposals to manipulate the accounts and evade taxes, auditors can handle creative accounting practices judiciously by adopting alternative ways which include: i) applying substance over form; ii) comparing the approach with prescribed accounting standards; iii) substantiating the approach through magnitude of disclosures; iv) elevating the issue to a more experienced professional of the engagement team or firm to assess if the attention of the client's upper management is needed to be called; v) consulting the entity's risk management and those involved with governance to discuss the possible huge exposure risk to the entity; vi) including the unsettled case in the management representation letter; and vii) withdrawing from the engagement, if necessary, as the last resort. There is a wide variety of motivations for managers to engage in creative accounting. As such, auditors must be vigilant in rendering auditing services to clients and be mindful of ensuring the integrity and reliability of the financial reports. They should be confident, updated, and must have a good understanding of the existing laws and regulations. At all times, auditors

should exercise due professional care and embrace professional skepticism in their work to minimize litigation risk.

V. RECOMMENDATIONS

Due to the dynamic and complicated nature of the business transactions and the liberty available in the accounting standards and procedures, it is not possible to completely eradicate the impact of creative accounting because of the involvement of managers and some auditors and slow work of regulatory bodies. But the following suggestions could be made to encourage judicious use of creative accounting so that the solutions neither mislead nor misrepresent the results of the business:

1. Regulatory bodies should make a law aimed at reducing the chances of alternative accounting methods or specify circumstances in which each method should be used including the application of judgment or discretion of management;
2. Require consistency on the use of methods, a company choosing a method which produced the desired picture in one year will be forced to use the same method in future circumstances where the result may be less favorable;
3. Artificial transactions can be tackled by continuously invoking the concept of 'substance over form' whereby the economic substance rather than the legal form of transactions determines their accounting substance;
4. Regulatory authorities should ensure that theaudit unit of all quoted companies is staffed with forensic experts and audit committee of such organizations should be mandated;
5. Regulatory bodies must streamline the accounting and auditing system and enforce a more effective and efficient corporate governance;
6. Public accounting firms of all sizes should become more engaged in the development of accounting curriculum in higher education institutions with a keen focus on anti-fraud and forensic accounting;
7. Public accounting firms should play an active role in developing training programs that combat fraud;
8. Finally, a similar study may be conducted to explore other areas in terms of factors affecting creative accounting practices and utilize divergent research method to strengthen the results of this paper.

ABOUT THE RESEARCHER

Fe R. Ochotorena earned her graduate studies, Doctor in Business Administration (DBA) at Polytechnic University of the Philippines, Manila, where she also obtained her undergraduate degree of Bachelor of Science in Commerce – Major in Accounting. She obtained her Masters Degree from Colegio de San Juan de Letran – Manila. Her first teaching experience was at Pamantasan ng Lungsod ng Maynila where she became the Officer-in-Charge, College Secretary, and Chairperson of the College of Accountancy. She is presently affiliated with Far Eastern University – Manila as the Assistant Program Head and concurrently the Research Committee Coordinator of the Accountancy Department.

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