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Contemporary issues in accounting: With special reference to creative accounting

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ABSTRACT

Almost all economic entities irrespective of their size, turnover, ownership, goods or services produced or traded have realized the fact that the human resources is their single most valuable and long-lasting resource which is capable of contributing heavily to the revenue or income generating activities. Hence, the corporate undertakings started thinking of accounting assets status to their human resource which it rightly deserves.

1. Introduction

One of the unique features and problems of accounting is not the non-availability of solution to problems of accounting but the availability of more than solution to each one of a few major Accounting problems. Inventory valuation; computation of annual depreciation; treatment of good will, overtime premium, idle time, costs, research and development costs are some of the examples for the accounting problems with diverse solutions. What is more important is that all those alternative diverse solutions are reckoned as sound practices by the professional accounting bodies. What is much more important is that the corporate entities are allowed to use any one of those accepted methods. Consequently, the financial results of corporate enterprise lack comparability their performance is influenced by even the diverse accounting methods.

Another important problem is, for some of the emerging accounting problems, no objective solution is available. In other words, for some of the contemporary or current accounting issues, single objective accepted solution is available. That means, there are a number of suggested methods as to how to assess the monetary equivalents of certain new kinds of accounting problems. Consequently, the corporate enterprisers have option to use any one of these suggested method, can manipulate their accounting figures and the financial performance to suit their requirements. As a result, users of accounting information, moves particularly the external parties are deprived of objective, comparable and reliable information.

2. Objectives

In this background, an attempt is made to identify and discuss the contemporary issues in accounting. Some of the current accounting issues are:

1. Accounting for price level changes
2. Valuation of accounting for human resources
3. Accounting for intangible assets
4. Brand accounting
5. Environmental accounting
6. Accounting for social responsibility of business
7. Nation income accounting
8. Creative accounting

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2.1. *Review of literature*

Naser K (1993) studied the creative financial accounting, its nature and uses.Bornea A, Rohen J and Sadan J (1976) examined the classificatory smoothing of income with extraordinary items.OriolAmat, John Blake and Jack Dowds (1998), Copenland R.M (1968)and Merchant K.A and Rockness J (1990) analyzed the ethics of managing earnings and creative accounting.

3. Materials and Methods

A systematic search was conducted to understand and analyze some current accounting problems. Many important reports and articles were used for reference.

4. Results, Analysis and Discussion

Some current accounting problems are (1) accounting for price level changes, (2) accounting for human resources, (3) accounting for intangible assets, and (4) brand accounting.

4.1. *Accounting for price level changes*

In the light of continuous rise in prices, the methods to account for price level changes were developed. These attempts resulted in the development of a few approached to account for price level changes including (a) general or current purchasing power method and (b) current cost accounting method. Here, the total impact differs from one approach to another because of three important reasons:

1. Common (general) price indices are used under general purchasing power method, whereas specific price indices are used under current cost accounting method.
2. Under general purchasing power method, all the items of financial statements are restated in terms of the price level at the end of the accounting year. And under current cost accounting method, important items are restated in terms of the average price level during the accounting year; and
3. In the use of general purchasing power method, all the items of financial statements are restated, whereas in the case of current cost accounting method, only three major items for groups of items of financial statements are restated. The three major items are (a) cost of sales (b) depreciation and (c) monetary working capital.[1] As a result, the users of accounting information will be deprives of comparable information.

4.2. *Valuation of and accounting for human resources*

These approaches can broadly classify into two categories: (a) human resource cost accounting methods, and (b) human resource value accounting methods.

1. The value of human resource differs from human resource cost accounting methods to human resource value accounting methods.
2. The value of human resource again differs from one method of human resource cost accounting (say, acquisition cost method) to another method of human resource cost accounting (say, replacement cost method). Similarly, the value differs from one method of human resource value accounting to another method of human resource value accounting.
3. Human resource cost accounting methods value the human resources at an unreasonably lower uses and the human resource value accounting of an unreasonably higher level;
4. Most of the approaches (except the acquisition cost method) fail to satisfy the verifiable objective evidence test and therefore, the values are highly subjective. Though the acquisition cost approach is based on the objectivity and on the verifiable evidences, the value of human resource (under this approach) goes on decreasing the experience of the human resource increases which is not acceptable; and
5. All the approaches fail to quantify the quantities (to human resources) which make up the human being and human resources.

4.3. *Accounting for intangible assets*

The corporate enterprises are investing and spending increasingly higher amount of money for the acquisition, development maintenance, enhancement of intangible assets such as scientific or technical knowledge; designs and implementation of new processes or systems including brand names and publishing titles; computer software; patents, copyrights, etc. These assets contribute to the future economic benefits in various forms including (a) revenue from the sale of goods and services, (b) cost savings or (c) other benefits resulting from the use of the asset by the organization. That means, these intangible assets possess the ability to contribute to the stream of revenue or income generation. Hence, they are recognized and assets by the corporate enterprises. Further, the accounting standard prohibits the reinstatement of expenditure recognized as an expense in previous annual financial statements or interim financial reports.[1] Only subsequent costs (i.e., the costs incurred after the time when the Intangible Assets first metes the recognition criteria) which amount for substantially and comparatively lower share in the total cost of intangible assets are capitalized and amortized.

4.4. *Brand accounting*

Brand has been defined as a distinguishing symbol mark, logo, name, word, sentence, or a combination of these items that companies use to distinguish their product from others in the market. Brand has created positive sentiment among the target audience, the firm is said to have built brand equity. Further, applying a trade name to a product or service is called branding and the legally protected brand names are called trademarks. A brand is a type of intangible assets.[2] There are a number of ways to assets the value of a brand. These include: cost-based approaches (historical cost method[3]and replacement cost method), market-based approaches (comparable market value method[4] and comparable royalty rate method[5]), economic approaches (capitalization of earnings method and royalty) and other approaches.

4.5. Creative accounting

The financial reports which comprise of, amongst others, the financial statements (viz., profit and loss account, and balance sheet) are expected to possess the valuable information content. These reports should contain valuable, relevant, accurate and objective facts and figures.

4.5.1. Meaning of creative accounting

The terminologies like earning management, earnings smoothing, financing engineering, income smoothing, cosmetic accounting, disclosure management, innovative accounting, etc are used to donate creative accounting. A few definitions presented below bring out a few dimensions of creative accounting.

NaserK (1993)viewed Creative Accounting as the process of manipulating accounting figures by taking advantage of the loopholes in accounting rules and the choices of measurement and disclosure practices in them to transform Financial Statements from what they should be, to what prepares would prefer to see reported and the process by which transactions are structures so as to produce the required accounting results rather than reporting transactions in a neutral and consistent way. Barnea, et al.(1976)stated Creative Accounting as the deliberate dampening of fluctuations about some level of earnings considered to be normal for the firm. Copenland (1968) also view Creative Accounting similarly by opining Creative Accounting as involving the repetitive selection of accounting measurement or reporting rules in a particular pattern the effect of which is to report a stream of income with a smaller variation from trend than would otherwise have appeared. Creative Accounting is any action on the part of management which affects reported income and provides no true income advantage to the organization and may in fact, in the long term, be detrimental (Merchant K. A and Rockness J, 1990)

The reasons as to why the Companies or managements resort to Creative Accounting vary from one company to another and also from one year to another. The important reasons are:

1. Income-based Tax Systemfor using Creative Accounting so that the taxable income can be manipulated, at least in the short-term, which will minimize the company's tax burden.
2. Income Smoothing: The corporate enterprises normally prefer to report a study and consistent growth in profit (even if it is at lower rate) than reporting volatile profits which vary from one period to another substantially.
3. Big Bath Accounting (e.g., in the case of recently Taken-over Company): when a company realizes, that, it is going to incur loss for the current year and when the company also realizes that there is no way to avoid loss-incurring situation
4. Matching Report Profit to Profit Forecast: The companies prefer to report, more or less, the same amounts of profit as forecasted prior to the commencement of the accounting period.
5. Matching Actual Profit with Analysts' Expectations or Predictions especially when the company intends to have longer capital market transactions.
6. Profit-based managerial Remuneration is another strong motive for manipulation of profit figures by the managerial personnel.
7. Insider trading is one of the important reasons for distorting the financial results (when managerial personnel engage in insider trading).
8. To Maintain or Boos the Share Price is another reason to manage earnings at the desired level.
9. To Distract the Stakeholders Attention from Creative accounting to report higher profit than the actual profit.
10. When a Company's borrowing capacity is linked to its Capital and Reserves, and are nearing the maximum limit, the company may resort to manage its earnings which in turn improve its reserves, and therefore, its borrowing capacity.
11. Price Revision Policy Pursued by the Governments with respect to their public utilities is another motive for the public utilities to report less profit and obtain permission from their Government-owners to increase price.

The companies have a number of avenues or opportunities to manage their accounts to suit their intended use and purpose. These are classified as:

1. Flexible Regulations which permit the companies to choose from a number of alternatives and the companies are also permitted by the Accounting Regulations to change their Accounting Policies.
2. Dearths of Regulation which are not fully regulated provide scope for manipulation of accounts
3. Estimation in Discretionary Areas such as provision for Bad and Doubtful Debts
4. Artificial Transactions such as sale and leaseback where in the sale price can be pitched above or below

the current value of the asset.

5. Genuine Transactions be timed in such a way so that the desired result can be generated.
6. Re-classification of items of Financial Statements

Table 1: Measures for minimizing accounting manipulation

Sl. No.	Creative Accounting Methods	Measures to Minimize Purposeful Distortions
1.	Existence of Diverse Accounting Methods	By reducing the number of permitted choices
2.	Biased Estimates and Predictions	By reducing the scope for estimation and predictions
3.	Entering Artificial Transactions	Substance over form
4.	Timing of Genuine Transactions	By Specifying Revaluation

Source: OriolAmat, John Blake and Jack Dowds (1998), "The ethics of creative accounting", Economics Working Papers 349, Department of Economics and Business, University Pompey Fabra.

4.5.2. *Creative accounting to minimize manipulations distortion*

Though it is very difficult to eliminate manipulation completely, some measures are available to minimize the same.Table 1

4.5.3. *Role of auditors*

Whenever there is a deviation from the established accounting procedure, the auditor is expected to draw the attention of the shareholders to the deviation by qualifying the report.

5. Conclusion

It is obvious that the Accounting Regulations provide for the use of diverse methods by different companies for similar problem. Further the companies are also permitted to shift from one method to another. These two Provisions are impairing the comparability part of quality accounting information. Besides, there is a number of emerging accounting problems for which objective measurement, though desirable and necessary, is not possible. Again, diverse methods, with option to shift from one to another, are suggested. As a result, the companies are able to manipulate their accounts distorting their earnings and other financial information.

6. Notes

1. Of course, another adjustment under Current Cost Accounting Method viz., Gearing Adjustment is not considered here as it influences only the extent of inflation burden, out of the total impact, taken over by the Debt Providers.
2. An intangible Asset should be recognized if, and only if:

- It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
- The cost of the asset can be measured reasonably (A526, paragraphs 20-1)

1. Intangible Asset represents an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rented to others, or for administrative purposes. (IAS 38, Para 7).
2. Historical cost denotes the actual cost incurred by an organization to establish its Brand
3. Comparable Market Value represents the value paid in comparable transactions recently
4. The amount of royalty paid for the use of a similar Brand is the Comparable Royalty Rate.
5. Royalty Method suggests to value the Brand based on the potential revenue generation by making use of the Brand name by another group.

7. Source of Funding

None.

8. Conflict of Interest

None.

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