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DETERMINANTS OF CREATIVE ACCOUNTING PRACTICE IN MALAYSIA

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Abstract

Whether being pushed to the edge or for self-interest, the financial report has been creatively presented to show outstanding performance and make the stakeholders happy. To an extreme extent, creativity becomes fraudulent. Past studies have shown that several factors contribute to the practice of creative accounting. However, studies focusing on individual and organizational aspects are still lacking. This study investigated the relationship between individual factors, that is, the accountant characteristic and organizational factors that are the company's corporate governance with creative accounting. The variable tested in this study is age, working experience, and education as individual factors, while corporate governance is the organizational factor. A final of 42 respondents consists of accountants that are members of the Malaysian Institute of Accountants (MIA). Data were gathered from a questionnaire adapted from previous studies. From the responses of 42 members of MIA, it was found that none of the individual factors that were tested had a significant relationship with creative accounting practice. This could indicate that the practice is committed by any person regardless of age, experience, and education level. However, corporate governance showed a significant relationship with the practice. This means that corporate governance is a determinant factor of creative accounting practice in Malaysia. Good governance and excellent internal control could curb the practice of creative accounting. This study is primarily significant to the users of financial reporting, especially the investors, in determining the credibility and reliability of the company's financial report. These findings show that effective internal control as a result of good governance is essential in ensuring a healthy financial report of a company.

Keywords: *Creative accounting practice, corporate governance, age, working experience, education background.*

Introduction

Creative accounting can be defined as the use of accounting techniques aggressively to show a 'beautiful' performance of companies in their financial reporting (Bhasin, 2016). Those companies will adjust their performance in the report by using creative accounting as much as possible to achieve the targeted result. The purpose of doing creative accounting can either be to present an impressive financial performance to other stakeholders or for self-compensation to the insiders (Umobong and Ironkwe, 2017). The Star newspaper did an impromptu survey on the awareness of people on corporate fraud in August 2016 in Kuala Lumpur. This was to identify to what extent they know about this issue. The survey was to correlate it with the situation being reported by the newspaper, where auditors find it tough to unmask corporate fraud. It was reported that more than 90% of individuals interviewed (23 out of 25) did not honestly know or want to comment about fraud. This showed that potential or current financial reporting users did not know what happened in the corporation.

Due to the rise of creative accounting practices that lead to earnings management worldwide, many efforts have been taken to restore confidence in the quality of financial reporting and the accounting profession. One of the efforts is to introduce international standards in financial reporting (Okoro and Okoye, 2016). Even though some countries have accounting standards in financial reporting, International Financial Reporting Standards (IFRS) increase the likelihood of boosting reporting transparency. This will result in a greater understanding of stakeholders in the financial results and reduce the usage of creative accounting practices. In addition, IFRS also facilitates cross-country comparability of the companies in the same

industry (Okoro and Okoye, 2016). When this feature is included, it will be easier for the users to detect if any manipulation has taken place in the respective company as they can now compare the performances easily. However, this standard is not far away from criticism and potential problems.

The level of creative accounting used differs in some countries based on the law and regulations. As in some small advancing countries like Greek, the creative accounting practice is considered at an acceptable level (Baralexis, 2004). Safta et al. (2020) studied the creative accounting practices in Romanian companies and indicated that 84% of their respondent involved creative accounting in their financial reports. Creative accounting practice has been seen as aggressive accounting rather than fraud (Sahiti and Aliu, 2017). This is because fraud is defined as the intentional misstatement which would cause the reader to alter their judgment and decision. However, creative accounting is not breaking the law and working within the regulatory system. Yadav (2014) states that creative accounting cannot be considered fraudulent, but as it takes the benefits of loopholes in the accounting standards, it can lead to illegal acts. Creative accounting practice shows that it impacts the reliability of financial reporting (Ismael, 2017). The techniques of creative accounting will affect the information produced in financial reporting and thus will reduce the quality of reliability of the report. It may also affect the company's share price and asset value (Gabar, 2015). Therefore, it can be concluded that this practice affects the reliability of financial reporting, and there is always a negative effect on the quality of financial reporting (Khamangy and Sadeegy, 2015; Alomery and Alameen, 2014).

However, creative accounting practice does not show any sign of declining either in Malaysia or worldwide. This might be due to the companies' benefits from using creative accounting. Some literature also mentioned that managers still use creative accounting to manage and prepare financial reporting because of some countries' loopholes in accounting regulations (Akpanuko and Umoren, 2018). The loopholes discussed include the regulatory flexibility, absence of law, the scope of managerial judgment and estimation of discretionary areas, the timing of transactions, the use of artificial trade and reclassification, and the presentation of financial members. Previous literature found that common individual factors that usually lead to creative accounting are the urge to get higher salaries and bonuses and to gain self-satisfaction (Catalina, 2017). Organizational factors have also been found to be the determinants of the creative accounting practice. Competition is one of the determinants of organizational factors (Remenaric et al., 2018; Catalina, 2017). However, other less discussed and tested determinants may also affect the practice of creative accounting, such as the characteristics of the accountants and corporate governance. Accountants' characteristics (based on age, education background, and working experience in the field) seem to have a positive relationship with creative accounting practice. The result showed that those accountants with a shorter experience in the area considered creative accounting a legal act (Marin and Mihaela, 2015). Ali (2016) found that corporate governance positively correlated with creative accounting practice. The underpinning theories for this study are agency theory and legitimacy theory. These theories relate to the function of accountants that must serve the company's owners (investors and shareholders) and society. Due to the gap in the earlier literature, this study would like to study the relationship between accountants' characteristics and corporate governance with creative accounting practice.

According to Marin & Mihaela (2015), accountants of younger ages ranging from 30-40 years old consider the usage of creative accounting as a legal act. However, this significantly contradicts the perception of more senior accountants over 40. The reason for this relationship is that most younger accountants see creativity as one of the qualities of professional accountants. While this quality can add value to the company, they are working with it either in the short term or in the long run (Marin & Mihaela, 2015). However, the age of the accountant is also considered to not correlate with the perception of creative accounting. This is because, nevertheless, the age of accountants does not affect their behavior of accountants. As many other characteristics can contribute to this matter, age is not one of them (Clemenceau, 2014). From the literature discussed above, hypothesis 1 is constructed as follows:

H1: There is a significant relationship between the age of accountants and creative accounting practice.

Accountants with less working experience will tend to see the usage of creative accounting as something legal and are intended to use it more commonly in preparing financial reporting (Marin & Mihaela, 2015,

Kirschenheiter and Melumad, 2002). This happened due to several reasons. Firstly, less experienced accountants do not know much about the company they are working with. Thus, it will be hard for them to align their interests with the company's interests. As a result, they tend to use creative accounting to manipulate the financial reporting as a company with sound financial performance or more profitable will reflect on the efficiency of the management, which in return be compensated for their performance. Secondly, it is related to the training they have attended. Junior staffs typically attend training that develops their skills and knowledge on the job instead of building loyalty and trust towards the company. Therefore, less experienced accountants tend to use and consider creative accounting practice more often in preparing financial reporting than more experienced accountants. Thus, hypothesis 2 is constructed as follows:

H2: There is a significant relationship between the working experience of accountants and creative accounting practice.

Gabriels and Van De Wiele (2005) found a different perception of creative accounting between accounting and non-accounting students. People with an accounting background (accounting as the primary course) are more aware of the possible consequences of creative accounting practice compared to those not from the accounting background (e.g., business course, statistics, engineering, etc.). In addition, people with an accounting background think that creative accounting practice is the responsibility of the accountants. This means accountants tend to use creative accounting more often compared to non-accountant (Gabriels and Van De Wiele, 2005). Hence, hypothesis 3 is constructed as follows:

H3: There is a significant relationship between the educational background of accountants and creative accounting practice.

A few corporate governance factors have been studied concerning creative accounting: involvement of outside directors, internal control mechanisms, product and market conditions, audit standards, goodwill of the firm, and capital market techniques (Yadav, 2014). Some of these factors showed a positive relationship with creative accounting. It means that the presence of these factors can lead to the existence of creative accounting practices in a company. The most vital factor in this research is the involvement of outside directors. The result shows that if outside directors of the company own a large block of stocks, then the manager practices less creative accounting. In addition, creative accounting practice will be reduced if the company involves more directors in its decision-making. Thus, hypothesis 4 is as below.

H4: There is a significant relationship between corporate governance and creative accounting practice.

Methods

The method for collecting data for this research is through questionnaires. Questionnaires were from questionnaires used by Gabriels and Van De Wiele (2005), Salome et al. (2012), Yadav (2014), Marin and Frumusanu (2015), and Rabin (2005). This study used simple random sampling in selecting the respondent. The target respondent is accountants registered with the Malaysia Institute of Accountants (MIA), consistent with the studies of Yadav (2014), Shahid and Ali (2016), and Rabin (2005). Questionnaires were distributed to the respondent via email.

The questionnaire is divided into three sections. The first section is the demographic profile of the respondents. The demographic profile is also the data needed for individual characteristics. There are three questions for the individual profile: age, education background, and working experience. The scale used is nominal. The second section of the questionnaire is on the dependent variable, the level of creative accounting practice in Malaysia. Thus, it is categorical and uses an interval scale. The last section of the questionnaire is on the organizational factor, which is corporate governance. There are 18 items used in measuring this variable. A final 43 useable and complete responses were analyzed. The data were analyzed using SPSS statistical program. Descriptive analysis was carried out to understand the qualitative information collected. Further, reliability, validity, and correlation analysis were performed to ensure that the data fit, and the results were reliable. Standard multiple linear regression analyses are used to test the hypotheses developed for this study.

Result and Discussion

For this study, multiple regression is used in analyzing the result. Multiple regression establishes a relationship between a dependent variable and one or more independent variables using the best fit straight line. The model fitting is as follows:

$$\hat{y} = \beta_0 - \beta_1x_1 + \beta_2x_2 - \beta_3x_3 + \beta_4x_4$$

Where: Y = Level of Creative Accounting Practice

x1 = Age of Accountants

x2 = Working Experience of Accountants

x3 = Education Background of Accountants

x4 = Corporate Governance

The results for hypotheses testing are presented in Table 1 below:

Table 1: Regression analysis

	Beta	Sig	Adjusted R Square
Age	-.214	.137	-.025
Working experience	.282	.095	-.015
Education background	-.243	.402	-.016
Corporate governance	.256	.031	-.516

Table 1 shows a result of regression analysis on the relationship between the age of accountants and creative accounting practice. From the result above, the p-value shows a result of .137 (> .05), indicating no significant relationship between these variables. This means that there is not enough evidence to say that age of an accountant would affect the practice of creative accounting. Therefore, hypothesis 1 is rejected. The result contradicts the study by Marin and Mihaela (2015) that found the age of an accountant has a strong relationship with creative accounting practice. However, the findings of this study are consistent with the result of Clemenceau (2014) that age does not matter in determining the creative accounting practiced by the accountant. Differences in the cultural and economic setting could contribute to differences in the result of this study and other studies. The Adjusted R Square value is 0.25. This indicates that there is no relationship between the age of the accountants and creative accounting practice.

The statistical test result determines the relationship between the working experience of accountants and creative accounting practice. The p-value shows a result of .095 (> 0.05). The result shows no significant relationship between the tested independent and dependent variables. In conclusion, the working experience of an accountant does not determine the practice of creative accounting. Hence, hypothesis 2 is rejected. This result is non-consistent with the results of Marin and Mihaela (2015) and Kirschenheiter and Melumad (2002), which found a positive relationship between the variables. In the same table, the result of Adjusted R Square shows only a 0.15 relationship. Thus, we can conclude that there is no significant relationship between variables.

Table 1 shows a statistical result on the relationship between the educational background of accountants and creative accounting practice. The study hypothesizes there was a significant relationship between variables. However, the p-value indicates no relationship as the value is .402, which is more significant than .05. Therefore, hypothesis 3 is rejected. The Adjusted R Square scores are 0.16, which explains a fragile relationship between these variables. It means that the educational background of accountants won't affect the practice of creative accounting. Perhaps due to a majority of the respondent having almost the same education and qualification background, this variable did not show any relationship with the practice of creative accounting.

Results for hypothesis 4 show that internal control has a substantial relationship with creative accounting practice, which means if there is excellent internal control in a company, it might affect the practice of creative accounting in a company. As the variable satisfied the assumption of linear relationship, hypothesis 4 is accepted. The result is supported by a study by Yadav (2015) that shows internal control might determine the practice used. This can be seen from the p-value (Sig.) in the table above. A P-value

lower than .05 indicates a significant relationship between independent and dependent variables. The Adjusted R square result, as shown in table 1, stated a score of 0.516. This explains that 51.6% of corporate governance factors may affect a company's creative accounting practice.

Conclusion

This study has found no significant relationship between the individual factors of accountants and creative accounting practice. The factors discussed in this study are age, working experience, and education background of accountants. As there is no significant relationship between the variables, we cannot assume that an accountant's characteristics may affect creative accounting practices. There are no specific characteristics that may influence the practice. Another independent variable of the study is the organizational factor which specifies corporate governance as the factor being tested. For this factor, factor analysis has been done before running a regression analysis to determine the relationship result with the dependent variable. The purpose of doing factor analysis is to ensure that the elements within the same scope are being grouped and to make it easier to run the regression analysis. The research shows that corporate governance significantly relates to creative accounting practice. Therefore, hypothesis 4 is accepted in that there is a relationship between corporate governance and creative accounting practice. This is consistent with the study of Yadav (2015) and Rabin (2005).

The findings of this study may provide additional evidence to the literature proving that different individual factors such as the characteristic of accountants (age, working experience, and education background) may not affect the creative accounting practice. Another contribution of this study is that it will help the users of financial reporting better understand the problem of creative accounting that may affect the company's reporting. Next, this study will also help to increase the effectiveness of management in a company. This refers to the organizational factor that significantly relates to the practice. However, there are some limitations to this study. Firstly, the number of respondents was small compared to the sample size needed. Even though the number of respondents was consistent with the prior research, it still showed a big gap from the actual sample size (Respondents: 42; Sample size: 338). Future research on the relationship of a broader corporate governance characteristic with creative accounting practices could shed more light on formulating a more robust corporate governance framework.

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Author Contribution

Faros Faizdnor Roslan: Conceptualization, Project administration, Writing – original draft, Methodology, Formal analysis, Data curation, Validation. Norhayati Alias: Writing – Review & Editing, Visualization, Validation. Raziah Bi Mohamed Sadique: Writing – Review & Editing, Visualization, Validation

Conflict of Interest

The authors declare no conflict of interest.

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