CREATIVE ACCOUNTING: AN EMPIRICAL EXAMINATION

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TABLE OF CONTENTS

Table of Contents 2

List of Tables 7

List of Figures 9

Abstract 10

Certification 13

Acknowledgments 14

Chapter 1. Introduction 15
1.1 Introduction 15
1.2 Annual Reports under Examination 15
1.2.1 Contribution to Public Practice 17
1.2.2 Building Knowledge About Creative Accounting 18
1.3 Motivation for the Study 18
1.4 Objective of the Study 20
1.5 Overview of this Research 21
1.5.1 Sample Selection 23
1.5.2 Data Collection 23
1.6 Testing for Creative Accounting 24
1.7 Creative Accounting Support 25
1.8 Chapter Summary 29

Chapter 2. Literature Review 31
2.1 Introduction 31
2.2 Financial Reporting 33
2.2.1 Defining Financial Reports 34
2.2.2 The Objective of Financial Reports 37
2.2.3 The Qualitative Components of Financial Reports 40
2.2.4 Production of Financial Reports 44
2.2.5 Users of Financial Reports 46
2.2.6 Usefulness of Financial Reports 50
2.3 Evolution of Financial Reports 54
2.3.1 Financial Reporting Requirements 55
Legislative Regulation 55
Professional Accounting Standards 57
Stock Exchange Rules 58
2.3.2 Financial Reporting for the Modern Corporation 59
1851 – 1900: Colonial Financial Reporting 59
1901 – 1950: State Financial Reporting 66
1951 – 2000: National Financial Reporting 70
2001 – Present: International Financial Reporting 74

2.4 Defining Creative Accounting 77
2.4.1 A Definition for Creative Accounting 78
Creative Accounting and Fraud 82
2.4.2 Examples of Creative Accounting Techniques 84
Accounting Method Change 85
Asset Valuation 86
Consolidation Treatments 86
Expenses Moved Interperiod 86
Extraordinary Items 87
Intangible Assets 87
Liability Reduction 88
Merger Accounting 88
Revenue Recognition 89
Tax Effect Adjustments 89
2.4.3 Motivators for Creative Accounting 90
Managing Market Expectations 91
Information Asymmetry 93
Managing Credibility 94
Treatment of Motivation 96
2.5 Research Identifying Creative Accounting 97
2.5.1 Gaps Appearing in financial Accounts 98
2.5.2 Taxonomy of Australian Creative Accounting Research 107
Specific Technique Identification 107
Measurement of Unexpected Accruals 110
Other (Historical Perspective and Value Relevance) 117
2.6 Chapter Summary 119

Chapter 3. Data and Methods 124
3.1 Testing for Creative Accounting 124
Time-Series vs. Cross-Sectional Study 127
International Financial Reporting Standards (IFRS) 129
3.2 Sample Selection 131
Selection Criteria for the ASX 200 132
Selection of Criteria Predating the ASX 200 134
Other Selection (Deselection) Criteria 135
Reconciliation of the Movement of Firms within the ASX 200 136
3.2.1 Companies Selected in the Sample 137
3.2.2 Methods Used to Collect Data for the Sample Companies 139
Published Annual Reports 141
Aspect Database Data 143
Verification Between Manual and Electronic Datasets 143
3.3 Measuring Creative Accounting Methodology 145
3.3.1 Evolution of the Jones Model : the Discretionary Accrual Model 148
3.3.2 Absolute Discretionary Accrual Models 152
3.4 Theory Development and Model Building 156
3.4.1 Control Variables 158
Cash Flow 159
Time 160
Sector 161

Size 164
Model Fitting and Validation 167
3.4.2 Normal Distribution Models 168
3.4.3 Gamma Distribution Models 170
3.4.4 GAP Indexation Model (Model 13) 173
Sector Gap Indexation Models 175
Identity of Outliers 175
NPAT Positive Linearity 176
Content Analysis (Case Study) 177
3.5 Chapter Summary 177

Chapter 4. Findings 180
4.1 Evidence of Creative Accounting 180
4.2 Distribution of Earnings 183
4.3 Unexpected Accruals (Jones Model) 196
4.4 Further Analysis 203
4.4.1 Sectors 1, 2 & 5 209
4.4.2 Sector 3 (Financials) 216
4.4.3 Sector 4 (Discretionary) 226
4.5 Chapter Summary 233

Chapter 5. Conclusions 237
5.1 Introduction 237
5.2 Evaluating the Findings 239
5.3 Contributions to the Australian Literature 245
5.4 Chapter Summary 248

Chapter 6. Limitations and Directions for Future Study 252
6.1 Introduction 252
6.2 Limitations 253
6.2.1 Data Error 253
6.2.2 Statistical Error 254
6.2.3 Model Error 255
6.3 Future Directions 257
6.4 Policy Implications and Standard Setting 258
6.5 Chapter Summary 260

BIBLIOGRAPHY 263

APPENDIX A 278
Sample Companies 278

APPENDIX B 282
Histogram Analysis 282

APPENDIX C 290
Models Output 290
Model 1: NPAT = Sector + Operating Cash flow 291
Model 2: NPAT = Year + Operating Cash flow 295
Model 3: NPAT = Large Cap + Operating Cash flow 299

Model 4: NPAT = Sector + Large Cap + Operating Cash flow 303
Model 5: NPAT = Sector + Year + Operating Cash flow 307
Model 6: NPAT = Sector + Large Cap + Year + Operating Cash flow 311
Model 7: (NPAT > 0) = Sector + Operating Cash flow.....315
Model 8: (NPAT > 0) = Year + Operating Cash flow.....319
Model 9 : (NPAT > 0) = Large Cap + Operating Cash flow.....323
Model 10 : (NPAT > 0) = Sector + Large Cap + Operating Cash flow 327
Model 11: (NPAT > 0) = Sector + Year + Operating Cash flow.....331
Model 12: (NPAT > 0) = Large Cap + Year + Operating Cash flow.....335
Model 13: (NPAT > 0)=LargeCap+Yr+Sector+OperatingCashflow 339
Model 14: Sales1 model - Cash= Revenue+ large_cap+ sector.....343
Model 15: Sales1 model - Cash= Revenue+ large_cap+ sector+ year.....344

LIST OF TABLES

Number *Page*

Table 1 Chapter 1 Summary 29
Table 2 Accounting Convention Development 42
Table 3 Membership of FRC & AASB 56
Table 4 Creative Accounting Techniques 84
Table 5 Chapter 2 Summary of Literature Survey 119
Table 6 SX200 firm Additions and Deletions 136
Table 7 ASX Eligible Firms for Sample 137
Table 8 Sample Selection by Industry 138
Table 9 Dependent Variables Collected from Annual Reports 140
Table 10 Source for Data Collected 141
Table 11 Data Verification Table 145
Table 12 Re-grouped Sectors Used in Model 163
Table 13 Top 20 Companies by Average Seven Year Capitalisation 166
Table 14 Top 20 Companies Aggregate Capitalisation Over Seven Years 167
Table 15 Normal Distribution Models 168
Table 16 Gamma Distribution Models 172
Table 17 Significance of Sector, Year, and Size in Model 173
Table 18 Chapter 3 Data and Methods 177
Table 19 Descriptive Statistics 195
Table 20 Variable Definitions 198
Table 21 Descriptive Statistics for the Jones Regression Model 199
Table 22 Spearman and Pearson Correlation Matrix for explanatory variables (n=497) 199
Table 23 Largest Identified Discretionary Accruals (497 firm years) 201
Table 24 Significance of Sector vs. Sector in Model 205
Table 25 Woodside Petroleum Reported Results ($mil) 212
Table 26 Content Analysis of Woodside Financial Statements 213
Table 27 Woodside Depreciation and Amortisation 214
Table 28 National Australia Bank Reported Results ($mil) 220
Table 29 Content Analysis of NAB Financial Statements 221
Table 30 News Corporation Reported Results ($mil) 229
Table 31 Content Analysis of News Corporation Financial Statements 230
Table 32 Chapter 4 Summary of Research Findings 233
Table 33 Chapter 5 Summary of Conclusions from Research 249
Table 34 Chapter 6 Summary of Limitations and Future Directions for Study 261

LIST OF FIGURES

Number *Page*

Figure 1 Distinction between Fraud and Creative Accounting 83
Figure 2 Relationship of the Model Variables 157
Figure 3 A Relativity River For all Years 174
Figure 4 Histogram of Distribution of NPAT (total sample) 184
Figure 5 Histogram of Distribution of NPAT (total sample) 187
Figure 6 Histogram of Distribution of NPAT (Sectors 1, 2 and 5) 188
Figure 7 Histogram of Distribution of NPAT (Sector 3 - Financials) 191
Figure 8 Histogram of Distribution of NPAT (Sector 4 - Consumer Discretionary) ... 193
Figure 9 Relativity River for Sectors 1,2 & 5 210
Figure 10 Woodside Petroleum Reported NPAT 213
Figure 11 Relativity River For Sector 3 218
Figure 12 National Australia Bank Reported NPAT 221
Figure 13 Relativity River for Sector 4 227
Figure 14 News Corporation Reported NPAT 230

ABSTRACT

CREATIVE ACCOUNTING: AN EMPIRICAL EXAMINATION

"Australian firms, already strong practitioners of creative accounting, are jumping on the bandwagon [of a change to an IASB standard allowing firms flexibility to amortise assets]" – Paul Kerin (The Australian, 13 April 2009). A search of articles in the Australian news media specifically using the words "creative accounting" reveals widespread use of this term. The world economic crisis of 2008 and 2009 has again placed a spotlight on financial reports of public companies and the accounting standards from which the reports are derived.

Despite some studies having suggested that investors are not fooled by creative accounting practices (that investors somehow see through accounting techniques and adjust for differences (Dharan and Lev 1993 p493), it seems clear that the market has been fooled by financial reports which did not reflect the real-world phenomena, at least anecdotally (Sterling and Harrison 1974 p147).

The accounting profession has a special franchise granted to it by the community, to appraise the value and legitimacy of end-of-year financial reports (Briloff 2002 p1). Some suggest creative accounting conjures perceptions of financial permissiveness, and the continued presence of creative accounting practices evidenced through autopsies of corporate failures is associated with a crisis of confidence in the Australian accounting profession (Clarke et al. 2003 pp29-30).

There has been limited empirical work identifying creative accounting in Australia (Healy and Wahlen 1999). A central thesis of this dissertation is to ascertain empirically the extent creative accounting may be present in financial statements of Australian companies from 1998 to 2004.

Three tests were utilised to obtain evidence which may be consistent with the potential presence of creative accounting: a histogram analysis (Holland and Ramsey 2003), a regression analysis based on the Jones (1991) model and a gamma regression model (developed within) with supporting company case studies. An initial sample comprised 71 firms (497 firm years) who were listed as top 200 Australia companies continuously in each of the seven years of the sample period. The financial sector has been included within this dissertation, in contrast to other Australian studies where this sector has been specifically excluded.

The findings of this dissertation provide evidence that certain Australian ASX 200 companies' financial reports are likely to contain creative accounting. The histogram analysis of the reported profits provides the strongest evidence that creative accounting is within the financial reports of certain sample companies, whilst the Jones (1991) regression analysis proves to be a weak indicator of creative accounting within the sample companies. An explorative model was developed and identified the financial reports of three companies which exhibited likely signals of creative accounting.

CERTIFICATION

I hereby certify that this thesis is original and does not contain without acknowledgement any material previously published or material which to a substantial extent has been accepted for the award of any other degree or diploma of a university or other institute of higher learning.

Stephen Max Crouch

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