

CREATIVE ACCOUNTING AND CORPORATE GOVERNANCE: IMPLICATIONS FOR FINANCIAL REPORTING TRANSPARENCY

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Abstract: This paper examines the relationship between creative accounting and corporate governance and their implications for financial reporting transparency. It synthesizes evidence on managerial motives, accounting techniques, governance conditions, audit quality, internal control, ethical leadership, and regulatory enforcement. A structured narrative review was conducted using peer-reviewed studies, professional reports, and institutional publications from 2010 to 2026, selected for thematic relevance and methodological quality. The findings associate creative accounting with performance pressure, flexible accounting choices, and information asymmetry. Independent boards, financially competent audit committees, robust controls, high-quality external audits, ethical leadership, and credible enforcement strengthen reporting discipline. Corporate governance therefore provides an integrated framework for directing managerial discretion toward reliable disclosure, stakeholder confidence, and sustainable corporate performance.

Keywords: Creative accounting, corporate governance, financial reporting transparency

1. INTRODUCTION

Financial reporting supports investment, lending, regulatory oversight, and corporate accountability by communicating information about performance, financial position, and cash flows. Its usefulness depends on relevance, faithful representation, comparability, and transparency. The G20 and OECD Principles of Corporate Governance place disclosure, board accountability, and the integrity of reporting systems among the foundations of effective governance and sustainable capital markets (OECD, 2023).

Financial statements also require managerial judgment. Accounting policies, estimates, provisions, impairment tests, valuations, revenue recognition, and transaction classification permit companies to represent complex economic activity. Creative accounting arises when this flexibility primarily serves a preferred reporting outcome. It includes the purposeful use of accounting choices, estimates, classification, disclosure, and transaction timing to influence the appearance of corporate performance while operating within, or close to, the boundaries of accounting regulation (Abed et al., 2022a). Its position on the continuum between legitimate judgment, earnings management, aggressive reporting, and fraud depends on intention, materiality, disclosure quality, and correspondence with economic substance.

Managerial incentives and information asymmetry provide the organizational conditions for these practices. Earnings targets, compensation arrangements, analyst forecasts, debt covenants, financing needs, taxation objectives, financial distress, and career concerns can direct attention toward short-term reporting outcomes. Empirical evidence associates creative accounting with reduced reporting credibility, while also showing that its techniques and consequences vary across firms and institutional settings (Khatun & Sobhan, 2025).

Corporate governance supplies the oversight framework through which managerial discretion is reviewed. Boards, audit committees, internal control systems, internal auditors, external auditors, professional bodies, and regulators contribute complementary forms of monitoring. Their combined operation can strengthen reporting discipline, support transparent disclosure, and reinforce stakeholder confidence. The present study synthesizes research on creative accounting and corporate governance, identifies the principal motives and techniques involved, and evaluates how governance, audit, ethical, and regulatory mechanisms contribute to financial reporting transparency.

2. LITERATURE REVIEW

CREATIVE ACCOUNTING, INCENTIVES, AND REPORTING QUALITY

Creative accounting encompasses accounting policy selection, estimate management, accrual-based earnings management, real activities management, classification shifting, income smoothing, and big-bath accounting. Accrual-based techniques influence provisions, impairment, depreciation, expected credit losses, inventory values, and revenue recognition. Real activities management operates through production, pricing, sales terms, advertising, research, maintenance, and other operating decisions. Classification shifting relocates recurring items within financial statements, while income smoothing and big-bath accounting alter the temporal pattern of reported performance.

Evidence from financial professionals connects these practices with efforts to reduce earnings volatility, improve reported income or cash flow, support market value, and meet external expectations (Honková & Myšková, 2024). A broader review of emerging economies identifies financial distress, leverage, loss avoidance, executive compensation, investor expectations, ownership structures, and regulatory conditions as

recurring incentives for accrual-based earnings management (Mlawu et al., 2025). These motives arise through the interaction of personal rewards, organizational targets, contractual commitments, and market pressures. The consequences concern the correspondence between reported results and underlying economic performance. Managerial judgment can incorporate private knowledge about sales, credit risk, asset values, and future cash flows when estimates follow documented assumptions and transparent disclosure. Reporting quality grows through consistent methods, appropriate controls, and clear explanations of estimation uncertainty. Creative accounting weakens this correspondence when accounting discretion becomes oriented toward predetermined targets. Khatun and Sobhan (2025) associate creative accounting practices with lower credibility and transparency in financial reporting.

Internal control quality shapes both opportunity and detection. Authorization, segregation of duties, reconciliation, documentation, management review, and information technology controls support accurate recording and timely correction. Evidence from French listed firms indicates that stronger internal controls constrain accrual-based earnings management and improve financial statement reliability, while real activities management requires wider attention to operating decisions and cash-flow patterns (Boulhaga et al., 2022).

CORPORATE GOVERNANCE, AUDIT, AND DISCLOSURE

Corporate governance combines structures, relationships, and control arrangements that direct companies and hold decision makers accountable. The board supervises strategy, risk, senior management, financial performance, and disclosure. The audit committee provides specialized oversight of accounting policies, significant estimates, internal controls, internal audit, external audit, and whistleblowing arrangements. Ownership structures, institutional investors, securities regulation, and accounting standards provide additional monitoring.

Governance effectiveness depends on substantive capability as well as formal structure. Director independence gains practical value through financial literacy, sector knowledge, reliable information, sufficient meeting time, and authority to challenge management. Audit committee expertise supports the interpretation of accounting standards, valuation uncertainty, unusual transactions, audit findings, and management-defined measures. Evidence from Vietnamese listed companies links stronger composite governance quality with lower discretionary accruals and lower real earnings management, with effects varying according to ownership conditions (Nguyen et al., 2024).

Board composition further shapes the information and perspectives available during financial reporting oversight. Evidence from companies listed in Warsaw associates greater female representation on supervisory boards with higher reporting quality and identifies valuable contributions from independent directors with international and board experience (Dobija et al., 2022). Audit committee size and financial expertise have also been linked with stronger risk disclosure, with external audit quality reinforcing several committee effects (El-Deeb et al., 2024).

External audit quality complements board oversight through competence, independence, professional skepticism, industry knowledge, and rigorous evidence evaluation. Audit committees create demand for assurance, while experienced auditors provide technical assessment and independent challenge. Bawuah (2024) found that audit committee effectiveness and audit quality constrained earnings management, illustrating the value of coordinated governance mechanisms. Oversight also needs to cover alternative reporting channels. Xia et al. (2024) found that audit committee financial expertise influenced the use of accrual manipulation, real activities management, and selected non-GAAP adjustments, demonstrating the adaptive character of reporting strategies.

Specialized disclosure governance can extend this monitoring beyond statutory financial statements. Companies with disclosure committees have produced higher-quality non-GAAP measures, while the combination of audit committee financial expertise and disclosure committee legal expertise has created particularly strong monitoring effects (Hao, 2023). These findings support direct coordination among boards, finance executives, legal specialists, internal auditors, and external auditors.

Disclosure standards reinforce this framework. IFRS 18 introduces defined performance subtotals and requirements for management-defined performance measures, supporting greater comparability and transparency in corporate performance information (IFRS Foundation, 2024). Effective implementation depends on disciplined managerial judgment, board supervision, audit procedures, and clear explanations of significant measures and assumptions.

ETHICS AND REGULATORY ENFORCEMENT

Ethical leadership establishes expectations concerning integrity, professional judgment, transparency, and responsibility. Senior executives influence reporting through target setting, remuneration, resource allocation, responses to unfavorable information, and support for independent control functions. Evidence from accounting professionals indicates that ethical leadership and ethical organizational climate contribute to stronger financial reporting quality (Rachmawati et al., 2025).

Regulatory enforcement complements internal commitment by increasing accountability and supporting organizational learning. Chung and Hwang (2025) found that directors with prior accounting-enforcement

experience subsequently served firms with lower discretionary accruals and fewer restatements. Cross-border regulatory cooperation has also been associated with improved accounting information quality through reduced incentives for earnings manipulation (Yu et al., 2025). Governance, ethics, audit, and enforcement therefore operate as an interconnected reporting system.

3. METHODOLOGY

The study applies a structured narrative literature review to examine the relationship among creative accounting, corporate governance, and financial reporting transparency. Narrative synthesis is appropriate for integrating conceptual, empirical, professional, and regulatory evidence across connected research fields (Snyder, 2019). Peer-reviewed articles, professional reports, regulatory publications, and institutional documents published between 2010 and 2026 were identified through Scopus, Web of Science, Google Scholar, ScienceDirect, SpringerLink, Wiley Online Library, and official accounting, auditing, and governance sources.

Search terms covered creative accounting, earnings management, reporting quality, corporate governance, board independence, audit committees, external audit, internal control, ethical leadership, and regulatory enforcement. Selection emphasized thematic relevance, methodological quality, publication credibility, and direct contribution to the study objectives. The evidence was coded and synthesized around managerial motives, accounting techniques, governance oversight, audit and control quality, ethical leadership, and enforcement. This approach supports an integrated interpretation of the mechanisms that shape reporting transparency.

4. THEMATIC FINDINGS

MOTIVES AND ACCOUNTING TECHNIQUES

The synthesis identifies performance pressure and information asymmetry as central conditions associated with creative accounting. Managers possess detailed knowledge about transactions, estimates, risks, and future prospects, while investors and creditors depend on published information. Compensation targets, market expectations, leverage, financing plans, taxation, career considerations, and financial distress can influence how this discretion is exercised. These pressures become stronger when performance systems rely heavily on annual accounting outcomes.

Creative accounting techniques form a flexible portfolio. Managers can adjust accruals and estimates, modify operating decisions, shift classifications, smooth income, concentrate charges in weak periods, or emphasize alternative performance measures. Monitoring in one reporting area can redirect attention toward another. Effective oversight therefore combines analysis of accounting estimates with review of operating patterns, cash flows, unusual transactions, non-GAAP measures, and estimation uncertainty.

GOVERNANCE, AUDIT, AND CONTROL

Independent boards and financially competent audit committees provide informed challenge, while internal controls embed reporting discipline within daily operations. External auditors assess material misstatement risk and accounting evidence, and internal auditors evaluate governance, risk management, compliance, and control processes. The strongest framework emerges through direct communication among finance functions, internal audit, external audit, risk management, and the audit committee.

The evidence indicates that formal independence gains effectiveness through expertise, information access, active engagement, and accountability. Audit committee oversight and audit quality operate as complementary mechanisms, while robust controls support authorization, documentation, reconciliation, estimate review, and timely corrective action. This layered assurance structure improves the detection of unusual patterns and reinforces reporting credibility.

Internal assurance depends on the competence and independence of control personnel. Accounting experience among internal control managers has been associated with stronger audit quality (Kim, 2023), while greater internal audit independence has been associated with higher financial reporting quality in listed Chinese companies (Wang & Liang, 2025). The practical contribution of these functions therefore reflects professional capability, organizational position, and access to the board as well as documented procedures.

ETHICS, DISCLOSURE, AND ENFORCEMENT

Ethical leadership connects formal governance with everyday organizational behavior. Realistic targets, long-term performance measures, protection of employee voice, and clear responsibility for reporting judgments support transparent practice. Disclosure requirements provide structure for communicating accounting choices and management-defined measures. Regulatory inspection, investigation, and sanctions strengthen these arrangements through market-wide accountability and learning across director and professional networks.

Professional accountability gives these arrangements practical continuity. Accountants, auditors, directors, and executives exercise judgment within ethical frameworks that emphasize integrity, objectivity, professional competence, transparency, and responsibility. When leadership supports open communication and independent assurance, reporting concerns can reach the audit committee before they develop into material misstatement. Governance quality therefore depends on conduct and information flows as well as formal organizational design.

5. DISCUSSION

The findings support an integrated interpretation of financial transparency. Creative accounting develops through the interaction of incentives, discretion, governance quality, audit effectiveness, ethical culture, and enforcement. Each mechanism addresses a distinct reporting risk. Boards review strategic and managerial conduct, audit committees examine accounting judgments, internal controls organize reliable information flows, auditors provide assurance, professional ethics guide judgment, and regulators reinforce accountability.

A narrow focus on discretionary accruals captures only part of this process. Managers can move among accrual choices, operational decisions, classifications, and alternative measures. Governance therefore benefits from linking financial results with cash flows, production, sales terms, discretionary expenditure, business strategy, and future operating capacity. Transparent explanations of policies, estimates, unusual transactions, and management-defined measures help stakeholders interpret reported performance.

These findings carry direct implications for governance practice. Boards can reduce short-term reporting pressure by balancing annual accounting indicators with cash-flow quality, strategic development, risk management, innovation, and sustainable value creation. Audit committees can request reconciliations between reported earnings, operating cash flows, non-GAAP measures, and significant estimates. Internal audit plans can integrate financial reporting risks with operational decisions, while external auditors and committees can maintain direct communication about management pressure, control deficiencies, and emerging disclosure risks. The synthesis also shows that a single governance characteristic provides limited explanatory value. Independence requires expertise and information access, audit quality requires organizational support and professional skepticism, and internal controls require competent people and consistent operation. Effective financial transparency arises when these elements reinforce one another. This perspective helps explain why formally similar governance structures can produce different reporting outcomes across companies and jurisdictions.

Empirical findings also encourage a contextual reading of governance indicators. A study of Vietnamese listed companies found a positive relationship between a composite board measure and financial transparency, alongside a negative relationship for the composite audit committee measure, with individual attributes displaying differentiated effects (Truong & Nguyen, 2024). Formal structures therefore warrant evaluation together with expertise, authority, information access, ownership conditions, and the quality of practical engagement.

The review also highlights the importance of coordination. Independence, expertise, and audit quality generate greater value when information moves effectively across the governance system. Ethical leadership strengthens this coordination by aligning targets and rewards with long-term value creation. Enforcement supports consistent application and transfers regulatory learning across organizations. Future research can examine transitions among creative accounting techniques, long-term effects of governance reforms, emerging-market and small-firm settings, and the influence of artificial intelligence, continuous auditing, data analytics, and digital disclosure on managerial discretion.

The narrative approach integrates heterogeneous evidence and also defines the scope of inference. The review identifies recurring relationships and institutional mechanisms rather than estimating a pooled causal effect. Future empirical studies can test the proposed interactions through longitudinal designs, cross-country comparisons, board and audit committee data, enforcement events, and measures that capture accrual, real, classification, and disclosure-based practices simultaneously.

6. CONCLUSIONS

Creative accounting constitutes a multidimensional reporting practice shaped by managerial incentives, accounting flexibility, governance arrangements, audit quality, ethical leadership, and regulatory institutions. Its implications for transparency depend on the alignment between accounting choices, disclosure, and the economic substance of corporate activity.

Corporate governance provides the central framework for directing discretion toward credible reporting. Independent boards, financially competent audit committees, robust internal controls, high-quality external audits, ethical organizational culture, and credible enforcement strengthen the reliability of financial statements. Their coordinated operation supports stakeholder confidence, informed economic decisions, sustainable corporate performance, and trust in capital markets.

COMPETING INTERESTS

The author declares that there are no competing interests related to this study.

DATA AVAILABILITY STATEMENT

The evidence synthesized in this narrative review is available in the cited publications and institutional documents.

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