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# IFRS Standards and Executive Remuneration

## The Influence on Accounting Manipulation

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## Abstract

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This paper studies the combined influence of the flexibility within accounting standards and executive remuneration on accounting manipulation. Accounting manipulation has been distinguished to be enabled by the inherent flexibility in the IFRS Standards. The standards require a level of flexibility in order to be suitable to companies in differing business environments. Using case companies, the methods of manipulating the accounting standards are studied. The elements of flexibility are identified by analysing the IFRS Standards that have been selected as a part of the case study analysis. Analysing the executive remuneration schemes of the case companies shows that companies are prone to pay executive directors large bonuses in the years before the manipulation becomes public. It can be assumed that executives have benefitted monetarily from the accounting manipulation in the form of bonus payments while manipulation could be exercised to conceal the business problems.

Keywords: accounting, manipulation, IFRS, executive remuneration, standards

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## **Glossary**

ACFE	The Association of Certified Fraud Examiners. It is the world's largest anti-fraud organisation with the aim to reduce business fraud world-wide.
CEO	Chief executive officer. The CEO has the highest position in a company and is elected by the board.
EBIT	Earnings Before Interest and Tax. A non-IFRS measure that demonstrates company's profitability without interest and tax expenses. Also referred to as operating profit.
IASB	International Accounting Standards Board. An independent private sector body that develops and approves the International Financial Reporting Standards.
IFRS	International Financial Reporting Standards. A set of accounting standards effective since 2001 for publicly traded companies to make them consistent and comparable around the world.
KPI	Key Performance Indicator. Measurements that assist in measuring strategic, financial, and operational performance of a company.

# 1 Introduction

Accounting manipulation occurs when the financial information of a company is being altered to the extent that it no longer presents the reality of the company's finances. As a result, problems arise. Investors make decisions based on false information, debt may be taken on without an ability to pay it back, and dividends and bonuses are paid without having the actual capacity to do so. In the worst-case scenario, the company may need to file for bankruptcy.

Accounting manipulation is possible essentially because of the inherent flexibility within accounting standards. The standards require flexibility in order to apply to companies functioning in differing business environments. International Financial Reporting Standards (IFRS) allow managers to take advantage of the grey area and loopholes to make the accounts more favourable to them instead of the users. It is in the favour of managers to manipulate the accounts as the result will often benefit them in the form of short-term incentives.

The motivation for practicing accounting manipulation is often varied and consists of various incentives. Generally, however, the aim is to make the company's financial year appear better than it is. In the background, there may be decreasing sales, unforeseen changes in the market, or a company-related scandal. The consequences are deliberately made imperceptible in the results, and manipulation of the numbers can assist in hiding it.

A company's failure as a result of accounting manipulation often raises concerns about the executives' bonus payment schemes. In many instances, company executives have received large bonuses a few years before the manipulation coming to light. Companies claim that executives are paid based on the company's performance, but this is not necessarily true in the big picture. The bonus payments made before the divulgence of the manipulation are not in

line with the company's performance (Thompson, 2016). The basis on which these payments are made is questionable. It is unsure whether unethical accounting methods are used to postpone the inevitable scandal.

This paper aims to identify the ways in which both accounting standards and executive remuneration schemes can provide incentives for accounting manipulation. Section 2 presents the methodology used in this study. In section 3 the motives and methods of accounting manipulation are identified. In section 4, the elements of executive remuneration are distinguished. Section 5 focuses on the chosen IFRS Standards subject to manipulation, and the weaknesses in those standards are identified. Section 6 incorporates a case study analysis to gain a more comprehensive insight into the issue. Real-life cases provide evidence to the assumptions made in the previous sections. An analysis of the case companies' remuneration schemes is conducted to determine whether they have an impact on manipulation. Lastly, section 7 presents the results of this study. After studying this topic, it can be identified that IFRS Standards and performance-based executive compensation schemes have an impact on accounting manipulation.

## **2 Research methodology**

This section provides information on how the study in this paper was conducted. The research methods were designed in a way that best assists in finding the impact of executive remuneration and accounting standards on accounting manipulation. A literature review coupled with real-world case studies was applied to address the issue. Based on a large amount of literature already available on the topic, a literature review provides a sufficient amount of information for this paper. Case studies provide relevance and link the issues to the real world as the effects can be studied more effectively.



Secondary data was used for this paper as the means of data collection. Sources, such as research papers, news articles, accounting standards, and annual reports, have been applied in data collection. Primary research was not required as it would not have brought any additional value in the scope of this research. The desired outcome can be achieved by combining a literature review with a case study analysis.

The exploratory research design was selected to understand and analyse the relevance of executive remuneration and accounting standards in the occurrence of accounting manipulation. The objective is to achieve conclusive results and to develop a sufficient foundation for the issue (Sreejesh, Mohapatra, Anusree, 2014: 31). Thus, a more detailed study on the topic can be conducted later. The aim is not to find a definite result but to discuss the findings and the gravity of the issue. This paper does not aim to find a causal effect between remuneration and accounting manipulation but to find the impact of remuneration and accounting standard flexibility.

At the centre of this paper is the case study analysis. This is accompanied by theory on accounting manipulation and executive remuneration. An analysis of specific IFRS Standards was conducted to emphasise the flexible elements of the standards that may enable manipulation. The case studies selected present four accounting scandals where two of the companies are still currently operating and the other two that led the company into liquidation. This selection aims to highlight that accounting manipulation does not necessarily lead to liquidation. Yet, accounting manipulation can have other severe consequences.

The IFRS Standards presented in this paper were selected on the basis of the initial case study analysis. Before selecting the specific standards, a decision between US Generally Accepted Accounting Standards (GAAP) and the IFRS Standards needed to be made. The latter were chosen as the cases selected are UK companies that require the application of IFRS Standards instead of the GAAP. Selecting the relevant standards required analysing the cases to such a degree that a specific standard could be distinguished. Gaining a preliminary

comprehension of the IFRS Standards and their contents was required for a standard to be allocated to a case study. After distinguishing five evident standards, they were studied more in-depth to discover the elements of flexibility.

This study has its limitations. The case study companies' accounting manipulation practices are not limited to only one specific manipulation method although only one practice was distinguished. In reality, it is typical that many different methods are employed to cover the desired information, but all the aspects cannot be identified in this paper because of time restraints. Moreover, the comprehensive accounting manipulation methods in each case cannot be studied because it requires having access to materials that are not available, such as internal company documents. Another restriction of this study is that it was not possible to interview an accounting or auditing professional to provide their interpretation on some aspects of the IFRS Standards.

### **3 Accounting manipulation**

This section explains what accounting manipulation means and distinguishes the differences between illegal and legal manipulation. The incentives of manipulation as well as the methods applied for manipulation are addressed. The incentives and methods presented are merely simplifications, and it is important to acknowledge that in reality, both are more complex. However, distinguishing them is important for understanding what motivates accounting manipulation and how it is practiced.

Accounting manipulation is not a new practice. Until the establishment of accounting standards in the 1930s, manipulation was seen as "acceptable accounting" (Giroux, 2019: 7). Since then, regulators have continued to develop accounting standards to better meet the demands of today's business world, yet manipulation of the accounts still occurs. Accounting manipulation is a highly

questionable practice especially when it is operated in the grey area of the regulations.

Financial reporting acts as a method to communicate a company's financial performance to a variety of stakeholders. These include various parties, such as investors, lenders, and other creditors. The financial statements are obliged to present a "true and fair" view of the entity's accounts to ensure the usefulness of the information to the users. This means that the financial information should reflect the "economic reality" the company operates in (Jones, 2011: 5).

However, due to the differences between companies and business environments, accounting standards require a level of flexibility to successfully present the accounts truthfully. Coincidentally, it is the element of flexibility that enables accounting manipulation.

Accounting manipulation can be divided into legal and illegal practices of manipulating accounts. Legal practices are often referred to as creative accounting, aggressive accounting, or earnings management. In all cases, the objective is to exploit loopholes in the existing standards. Thus, accounts no longer present the economic reality but instead serve the interests of the preparers of the reports. Often, this results in a more attractive image of the financial position of the company. This highlights the dilemma that exists within the regulatory framework; without flexibility, companies cannot provide a "true and fair" view of their business while flexibility enables the misuse of the standards.

Illegal accounting refers to fraud. While different types of fraud exist, they all involve breaking the law or violating the accounting standards. The focus of this paper will be on financial statement fraud. The Association of Certified Fraud Examiners (ACFE) (2020: 1.203) defines financial statement fraud as deliberately misrepresenting the financial position of an entity by intentional misstatement of figures or disclosures in the financial statements. The aim is thus to delude the users of financial statements.

Creative accounting and fraud can exist without the other, although legal manipulation can often gradually lead to fraud. Using creative accounting practices may begin as a means to delay the consequences of the undesired business problems. These problems can otherwise prevent the company from meeting the earnings expectations or from having access to needed financing. Unless these problems can be fixed, they can start accumulating to the extent where it is inevitable to take upon illegal practices to keep the problems from uncovering.

Accounting manipulation reflects greatly on the financial markets. A distorted image of an entity's financial situation can result in overpriced securities and allow the company too much debt (Sadka, 2006). Furthermore, investors are likely to lose billions when the manipulation becomes clear and stock prices fall. Accounting frauds can be costly and potentially lead to bankruptcy. According to a study by Karpoff et al. (2008), the average price of companies falls by 38 percent due to loss of reputation, the deterioration of the prospects, and the legal costs of lawsuits at the moment of bankruptcy (cited in Amat, 2019: 78). The well-being of employees decreases as they may lose their jobs and the benefits that come with it, in addition to retirement funds and possible savings. Managers are dismissed, fined, or prisoned. Distrust in supervising institutions also increases; auditors are accused of not recognising the signs of manipulation and receive penalties.

### 3.1 The incentives for manipulation

The incentives for both legal and illegal manipulation are similar, yet greater for the latter. Manipulation of the accounts often begins when a company's results do not meet the expectations (Giroux, 2018: 8) with the aim of making the company's earnings appear better than they are. Sometimes the incentives are personal. Directors benefit monetarily by enhanced performance as it may increase their salaries and bonuses. Furthermore, performance affects the

amount of directors' remuneration in the form of provisions of shares and share options (Jones, 2011: 34). However, there are also other than monetary incentives. Appropriate results may provide them security regarding their jobs and personal satisfaction.

The most common components causing fraudulent behaviour are referred to as the Fraud Triangle, a framework designed by an American sociologist Donald R. Cressey. The framework includes situational pressures on the company or the manager, the opportunity to commit fraud with a small possibility of being detected, and the ability to rationalise the behaviour to justify the crime (ACFE, 2020: 1.205). The same elements can be applied to legal manipulation practices, too, because of the similarities between the two practices. The incentives for fraud can be more dramatic than for legal manipulation as the effects are, too.

The case studies provide evidence for the impact of personal incentives. It is a common practice that companies' executive remuneration is based on the company and individual performance. Thus, the better the result for the financial year, the higher the bonuses. Top directors have the final say in the financial reports of the company, hence increasing the risk of publishing flattering information that will benefit them personally.

### 3.2 Methods of accounting manipulation

Financial information is generally manipulated in two ways: by overstating assets or revenue, or understating liabilities and expenses (Jones, 2011: 44). There are some differences between the practices for creative accounting and financial statement fraud but the two commonly overlap. The means of manipulation are generally more drastic in financial statement fraud than they are for creative accounting. Because of the similarities, the basic methods can be studied jointly. In reality, the methods applied are more elaborate and difficult

to detect. The methods introduced in this section will provide a basic understanding of the issue.

It is important to understand that accounting manipulation is essentially enabled by the inherent flexibility within the accounting standards. The accounting equation that determines double-entry bookkeeping, presented in Figure 1, is the core of that flexibility. The equation reflects the basic symmetry in accounting where debits equal credits. Debits are assets and expenses, and credits are income, liabilities, and equity. Every transaction affects the debit and credit sides of different accounts. Thus, accounting manipulation is essentially enabled by changing the core elements of the equation (Jones, 2011: 45). For example, as assets and expenses are both classified as debit, classifying an expense as an asset will not cause an imbalance of the accounts.

$\begin{aligned} \text{DEBITS} &= \text{CREDITS} \\ \text{Assets} + \text{Expenses} &= \text{Income} + \text{Liabilities} + \text{Capital} \end{aligned}$
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Figure 1. Accounting equation for double-entry booking (Jones, 2011: 45).

Jones (2011: 46-61) has studied the different methods of accounting manipulations and has grouped them into five categories: increasing income, decreasing expenses, increasing assets, decreasing liabilities, and increasing operating cash flow. Manipulating cash flow is the most challenging as cash cannot be estimated to the same degree as the other items. The former methods are in a sense easier to manipulate. The methods presented here are merely simplifications and limited as in real life the means are more complex and tend to consist of multiple different methods. However, it is significant to present these as some of the methods are applicable to the case studies.

Increasing income can be done by recognising sales prematurely. According to Jones (2011: 46), this is one of the most prevalent methods of creative

accounting. Accounting standards provide a level of latitude in determining when a sale is recognised. The entity must only be able to justify that its income recognition policy is well justified. Examples of this method provide the cases of Carillion and Tesco but in different ways. These will be studied more closely in section 4. Another tactic is to include non-operating profits in the operating profits. The idea is to include one-off sales or profits not related to the normal operations in the operating profit, making the result appear better. Thomas Cook's case presents this method but in reverse: instead of including non-operating profits, they were excluding operating expenses and classifying them as non-operating expenses. Other methods include, but are not limited to, increasing interest receivable, treating loans as sales, and swapping products.

Decreasing expenses can occur by increasing closing inventory. This can be an attractive method as closing inventory is shown in both the balance sheet and the income statement. The balance sheet shows the current level of inventory whereas the income statement shows the increase of profit as there are less expenses to be decreased from the cost of sales. Thus, the greater the value of closing inventory, the higher the profit. Inventory is counted and valued annually, making it more prone to manipulation (Jones, 2011: 50). Inventory can be overstated by either misstating the quantity of the inventory or by valuation. Moreover, production overheads can be included in inventory. Production overheads can be highly subjective due to their nature, increasing the possibility of manipulation. Ted Baker's case presents an example of overstated inventory. Other methods include using over-generous provisions, reducing taxation, big bath (writing off as many costs as possible at once to improve future performance), and capitalising depreciation lives.

Increasing assets aims to improve the asset base. A common method of manipulation is enhancing goodwill. Goodwill is not subject to amortisation like other intangible assets. Instead, annual impairment tests must be conducted to test whether there have been changes in the value. Managers are not eager to impair goodwill as it would send a message of a poor acquisition decision which means goodwill can be left on the balance sheet untouched, inflating the value

of assets on the balance sheet. Carillion is not the only company of the cases with issues with unimpaired goodwill, but it will be studied in more depth. Other methods include employing mark-to-market accounting and revaluing tangible fixed assets.

Decreasing liabilities can be more complex than the former methods. Off-balance sheet financing refers to a method where liabilities are removed from the balance sheet to make it appear stronger or to avoid breaching loan covenants. This study does not include a case of the off-balance sheet financing but, for example, Jones (2011: 60) addresses the case of Enron as an example. The company was big on employing this scheme by moving its liabilities to the balance sheets of its subsidiaries. Another method is re-classifying debt as equity which is another complex topic. This can be done by dressing up loans as equity, for example, through convertible loan stock bonds that can be converted into equity at a future time (Jones, 2011: 60).

Lastly, increasing operating cash flow aims to maximise operating cash inflows and/or minimise operating cash outflows (Jones, 2011: 61). This method focuses on making the definition of operating cash flow as wide as possible so that as many items as possible can be included in the operating cash flow. Classifying non-operational items into operational cash flow results in improving the image of a company's generated cash inflows. Cash flow statement provides users information about the reporting entity's operations in comparison to its financing and investing activities (Gordon, et al., 2017). Thus, manipulating it creates great distortions in understanding the operations of a company.

## **4 Executive remuneration**

This section will provide an understanding of how executive compensation is constructed. The differences between short-term and long-term incentives are



distinguished. The connection between the company's performance and CEO turnover is discussed. Executive remuneration can function as a personal incentive for accounting manipulation and is, thus, relevant to understanding the occurrence of such manipulation.

Executive compensation is the combination of salary, benefits, and short- and long-term incentives executives receive based on performance. The three core components of compensation are performance measures, performance targets, and structure of the pay-performance relation (Murphy and Jensen, 2011).

Remuneration aims to create a link between performance and the company's strategy to ensure the common interest of the group and the individuals.

Performance can be measured based on either individual or group performance and typically a combination of those measures is used. On average, 29 percent of the compensation is based on individual performance and 71 percent on the performance of the organisation (Groysberg, et al., 2021). Generally, a set target level must be met to receive additional compensation in addition to base salary, benefits, and pensions. The targets form a pay-out curve that provides a range of different bonus payment outcomes. Depending on the extent to which the targets have been met, a bonus will be paid accordingly.

A remuneration committee is the decision-making body for setting the remuneration package for executive directors and recommending the remuneration policy (Thomson Reuters, 2022). The remuneration committee consists of other non-executive directors in the company. The decisions regarding the executives' pay are made with the exclusion of them to minimise the conflict of interest. External advisors may also be used to provide advice regarding market incentives, job evaluation, pensions, and benefits (Thomas Cook, 2018).

Based on case companies, the base salary for a chief executive officer (CEO) varies between £459,000 and £1,145,000. In addition to base salary, benefits and pensions are a part of the fixed pay. Adding those to the base salary can

total the fixed pay up to over one million. Thus, executives receive a high salary even if any annual bonuses or long-term incentive rewards do not materialise.

The maximum annual bonus figure for chief executive officers (CEOs) can be between 100 percent and 250 percent of base salary, based on the remuneration reports of the case companies. However, the maximum level is not always researched due to the structure of bonus payments. Figure 2 presents a typical annual bonus plan. A lower performance threshold must be met for any bonus payments to be made. Additionally, there are typically performance targets. The upper performance threshold sets the maximum limit of payable bonus for the period. Between the two threshold points, performance has an impact on the amount of bonus to be paid. Thus, the bonus varies throughout a range of possible performance outcomes.

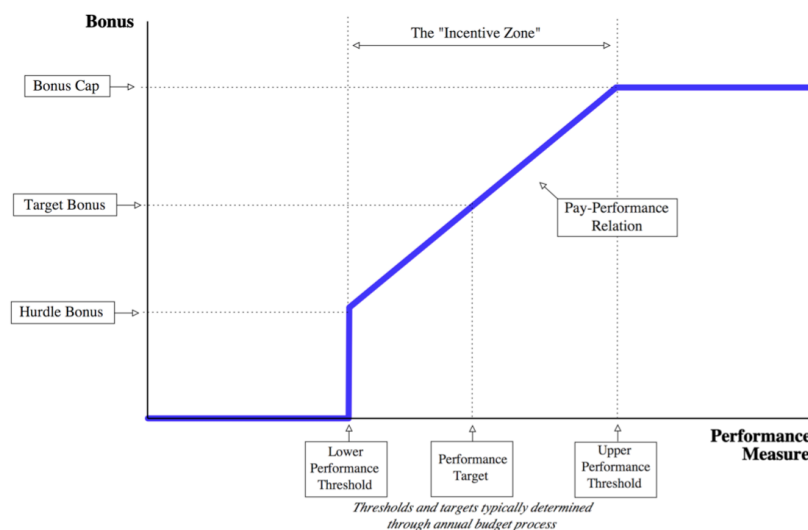


Figure 2. A typical bonus plan (Murphy and Jensen, 2011).

Performance objectives are set to determine the amount of compensation executives will be rewarded. The objectives can be, for example, financial, non-financial, strategic, or operational. Financial targets are commonly based on profit and growth. Non-financial targets can involve indicators of innovation or customer satisfaction. Concerns have been raised over non-financial targets in compensation in whether they are easier to manipulate and able to recompense CEOs for actions that should be viewed as their day-to-day tasks (Bachmann,

et al., 2019). The immediacy of bonuses paid in cash can provide strong incentives to manipulate those targets. Key performance indicators (KPIs) are regularly used in the measurement of performance. The measures used are described in the remuneration policy of the company. Generally, performance objectives are divided into group objectives and personal objectives. The weights of each element may vary but financial performance metrics typically have a heavier weight.

A study by Bachmann, et al. (2019) finds that influential CEOs receive large cash bonuses that are typically based on non-financial targets. They are also able to have an effect on the adoption of performance measures so that the measures are beneficial to themselves. Moreover, the study found that if the information on the type of non-financial targets is not disclosed, the companies suffer from lower subsequent performance than compared to those who disclose such targets. Interestingly, Ted Baker was the only company who did not disclose the non-financial targets in their remuneration policy.

Long-term incentive plans aim to reward executives for reaching goals that result in increased shareholder value (Kenton, 2020). Like annual bonuses, long-term incentives are used to motivate the growth of the company. Long-term incentives aim to encourage directors to think on a longer-term basis and make sustainable decisions instead of focusing on short-term targets (Woolf, 2020). In order to be effective, the long-term targets should be distinct from short-term bonus targets.

According to Kenton (2020), long-term incentives are often rewarded in the form of stock options, deferred shares, or restricted stock. The issue with stock options is that they are uncertain in nature and in the worst-case scenario may not reward the executive at all. Deferred shares and restricted stock could thus be more beneficial. The concern with them is, however, that they may not be as effective in motivating for better performance as stock options (Woolf, 2020). Stock options generally vest after three years but the time period may vary depending on the company. There may be other performance targets that

determine the vesting of those options. For example, Ted Baker's (2019) remuneration policy requires a 10 percent increase in the share price over a three-year period for the shares to vest. Other types of measures can be a combination of financial measures and share price-based measures. Moreover, payment of dividends is only made to options that have vested and been exercised. Long-term incentives can also be used as a method to engage executives with the company. Share options that have not vested by the time of executive resignation will lapse. The use of performance targets as a determinant of receiving those options also motivates the executive to work towards the common goal. Hence, it is more beneficial for the executive to operate in a way that drives performance.

The compensation system itself is used to address the issues highlighted by the agency problem. The agency problem refers to the conflict of interest between managers and shareholders: without a sufficient compensation scheme, the managers would have the incentive to act in the best interest of themselves instead of the shareholders (Chen, 2021). The remuneration packages are designed to provide CEOs with incentives to align their interests with those of shareholders (Conyon, 2006). The objective is to minimise managerial opportunism and motivate CEOs by offering stock options and restricted stock.

Despite the incentives that aim to drive better performance and motivate CEOs to work towards a common goal, CEO turnover has been increasing. A study by PwC (cited in Karlsson, Turner, and Gassmann, 2019) found that the CEO turnover at the world's 2,500 largest companies was 17.5 percent in 2018 – above what has been the norm for the last decade. This has been the highest rate of CEO departures reported. Moreover, CEO tenure has had a downward trend since 2003. In 2003, the average CEO tenure was 8.5 years and in 2020 it was only 3.7 years (Smyth, 2020).

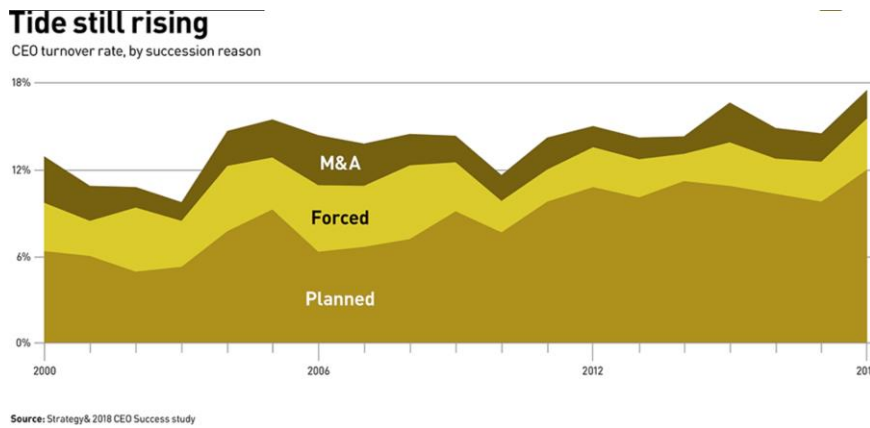


Figure 3. CEO turnover rate between 2000 and 2018 by succession reason (Karlsson, Turner and Gassmann, 2019).

The reasons for CEO departure are presented in Figure 3. Planned CEO departure appears as the most common reason for departure throughout the years. Typically, the lack of good performance may drive the CEO out of office. The study by Karlsson, Turner, and Gassmann (2019) indicates that often underperformance is the result of a succeeding CEO taking the place of a long-serving CEO. Evidence on poor performance and CEO turnover is provided in section 6 as a part of the case study analysis.

## 5 Flexible IFRS Standards

In this section, the International Financial Reporting Standards are introduced and some significant standards that enable manipulation are identified. These particular standards will be studied more in-depth and the weak spots that emphasise flexibility will be distinguished. Based on those weak spots it can be determined how exactly the standards can be manipulated.

International Financial Reporting Standards (IFRS) are a global set of accounting standards for public companies that aim to provide transparency and comparability to financial reporting (Palmer, 2021). The standards are developed by the International Accounting Standards Board (IASB) based on

some fundamental principles. The key concepts and principles that are further explained in the Conceptual Framework for Financial Reporting are reflected in the requirements of IFRS Standards.

The Conceptual Framework aims to meet the general purpose of financial reporting which is to provide the required information to the users of financial information who are unable to control the preparation of the reports (Picker, et al., 2019: 30). By following the Framework, standard setters can better develop a consistent set of accounting standards and the preparers of the financial statements can better apply the standards when preparing those statements. Relevance and faithful representation are described as the two most fundamental qualitative characteristics in the Conceptual Framework (International Accounting Standards Board, 2018). In addition to these, financial information must also be comparable, verifiable, timely, and understandable.

Prudence is a concept once included in the Conceptual Framework. Until 2010, it was described in the Conceptual Framework paragraph 37 as using “a degree of caution” when using judgement and making estimates required in conditions of uncertainty. Employing this degree of caution would lead to assets and income not being overstated and liabilities and expenses not being understated (Javed, 2021). Prudence was seen as an element of neutrality and inherent in the Framework without the explicit mention of it. Yet some argued that prudence led to accounting conservatism where the book value of a company must be less than its economic value (Barker, 2015). Thus, according to accounting conservatism, losses must be recognised as soon as possible while gains shall be recognised only when their realisation can be verified. This creates a great asymmetry between the recognition of gains and losses. Because of the contradiction between the purpose of prudence, it was removed from the Framework. In 2014, prudence was reintroduced as a means to support neutrality, instead of creating an unintended asymmetry between the recognition of gains and losses.

The standards to be studied were selected based on a preliminary study on accounting manipulation cases. After selecting the appropriate cases for this study, the accounting standards were identified based on the cases. It should be considered that these standards provide a single aspect to the case studies as identifying all possible manipulated standards is not possible. However, the standards chosen possess elements of flexibility and are thus prone to manipulation. There may be other standards that also possess elements of flexibility, but the ones studied in this paper are relevant to the cases. Evidence of manipulation will be presented in Section 6 as a part of the case study analysis. The standards studied in this section include IFRS 15 Revenue from Contracts with Customer, IFRS 3 Business Combinations, IAS 36 Impairment of Assets, IAS 2 Inventories, and IAS 1 Presentation of Financial Statements.

## 5.1 IFRS 15 Revenue from Contracts with Customer

IFRS 15 Revenue from Contracts with Customer (International Accounting Standards Board, 2014) establishes the principles according to which an entity will recognise revenue. The principles regard the nature, amount, and timing of revenue and cash flows as stated in IFRS 15. The amount recognised must reflect the consideration to which the entity expects to be entitled to after transferring goods or services to a customer. IFRS 15 replaced the former revenue recognition standards IAS 18 Revenue and IAS 11 Construction Contracts in 2018 (IFRS Foundation, 2018). Recognition of the former standards is important in this study as the cases related to revenue recognition took place prior to 2018. However, as IFRS 15 is the currently effective standard it will be studied in greater detail than its predecessors.

IFRS 15 introduces a five-step model for recognising revenue (International Accounting Standards Board, 2014). First, an entity must identify the contract or contracts with a customer. The standard has clear definitions for determining whether an arrangement can be considered a contract and how to manage

combined contracts. Second, an entity must identify which of the promised goods or services will be treated as individual performance obligations. Third, the transaction prices shall be allocated to each performance obligation. Fourth, revenue can be recognised once the identified performance obligation has been satisfied. This occurs when the control of the promised good or service has been transferred to the customer. Lastly, contract costs must be identified. These can be either supplementary costs for obtaining the contract or costs that will incur in order to fulfil a contract.

An interesting element lies in the third step of the model where the transaction price is determined. Paragraph 50 of IFRS 15 states that if the consideration promised includes a variable amount, the amount a company is entitled to must be estimated and included in the transaction price. The variable consideration can include, for example, discounts, rebates, or other performance-related incentives. The variable can be dependent on the customer meeting specified performance obligations. Thus, there can be uncertainty whether the target will be met and whether the amount of consideration will be received. The estimation of the amount must be done by using an expected value or a most likely amount approach according to which approach better predicts the amount to be received (Picker, et al., 2019: 94). When applying either of the approaches, all historical, current, and forecasted information available must be considered. In some instances, the consideration is paid to the customer, either by cash or in the form of non-cash items, such as vouchers. This section links to the case of Tesco where this variable consideration was relevant in recognising commercial income.

Another possible loophole exists in the fourth step of measuring the satisfaction of performance obligations. IFRS 15 allows companies to decide for each performance obligation whether it will be satisfied over time or at a point in time. If the criteria for a performance obligation satisfaction over time is met, the progress of transferring the promised goods or services must be measured. On the contrary, if there is a distinct point at which the control of a good or a service is transferred, performance obligation can be seen as satisfied at a point in



time. Measuring the satisfaction of a performance obligation over time can be more prone to subjectivity. Although the standard includes the criteria for satisfaction over time and clear measures of progress, the circumstances in real life may not be as clear. The case of Carillion will provide evidence of the abuse of revenue recognition that can be linked to IFRS 15, too.

The most flexibility appears to be in the steps three and four of the revenue recognition model. Both steps require the use of estimates that are made by individuals. This subjectivity increases the risk of manipulation as estimating is a difficult practice and it is easy to make false judgements based on an individual's hopes for the future.

#### 5.1.1 IFRS 15 replacing former revenue standards

IAS 18 Revenue and IAS 11 Construction Contracts preceded IFRS 15 until 2018. IAS 18 addressed issues regarding when to recognise revenue and how to measure revenue (International Accounting Standards Board, 1993). The standard defines revenue as “the gross inflow of economic benefits during the period arising from the course of the ordinary activities of an entity when those inflows result in increases in equity”. As IAS 18 was not suitable for construction contracts with longer payment terms, IAS 11 was needed. IAS 11 determined the timing for recognising revenue in such construction contracts that took a long time before completion (International Accounting Standards Board, 1993). If revenue had been booked according to IAS 18, the revenue would have been recognised only when the contract was fully completed. As a result, the accounts would not have provided a “true and fair” view of the business. Thus, IAS 11 required that the revenue on construction contracts was recognised according to the degree of completion of the contract (ACCA, n.d.).

As IAS 11 had the same element of gradual recognition as IFRS 15, it can be assumed that both standards thus provide opportunities for misuse by recognising the level of completion on false pretences. IAS 18, on the other

hand, had other similar elements to IFRS 15 as they both are relevant to measuring revenue. Because of the similarities between the standards, they are comparable.

## 5.2 IFRS 3 Business Combinations and IAS 36 Impairment of Assets

The standards regarding business combinations and impairment of assets will be studied in this section jointly as together they are relevant in accounting for goodwill. Goodwill is considered as “the amount one company pays for another over and above the appraised value of the target’s assets, less any assumed liabilities” (Ford, 2018). It is an intangible asset arising from a business combination, where an acquirer obtains control of one or more businesses. However, its treatment remains controversial. Goodwill does not have monetary value: it cannot be sold, and it typically loses its value in the event of bankruptcy. Its status as an asset is rather questionable.

IFRS 3 Business Combinations (International Accounting Standards Board, 2008) determines the initial recognition of goodwill. To calculate goodwill as a part of the acquisition, the consideration transferred to the acquiree and the net fair value of identifiable assets and liabilities must be calculated (Picker, et al., 2019: 386). By comparing the two figures, the existence of goodwill can be measured. Goodwill will then be recognised as any other identifiable asset. The issue here is that the amount of consideration paid in addition to the assets and liabilities can be difficult to determine. Thus, it is possible for the acquirer to pay overprice for the acquisition to make it appear more successful. The reason for paying overprice for an acquisition is that it can inflate statutory earnings (McBride, 2016). However, IFRS 3 emphasises the measurement of “core goodwill” that comprises going-concern goodwill and combination goodwill. It aims to avoid the incorporation of the excess of fair values of recognised assets, fair values of assets that are not recognised by the acquirer, and

overvaluation of the consideration (Picker, et al., 2019: 385). This aims to demand accurate measurement of the consideration.

The main issue with goodwill is that, unlike other intangible assets, goodwill is not subject to amortisation. Instead, annual impairment tests must be conducted as detailed in IAS 36 Impairment of Assets (International Accounting Standards Board, 2004). Additionally, there is no opportunity for revaluation of goodwill because IAS 38 Intangible Assets does not allow the recognition of internally generated goodwill (International Accounting Standards Board, 2004). Testing for impairment is crucial in order to provide timely loss recognition and to maintain prudence in financial reporting (Filip, Jeanjean, and Paugam, 2014). However, the treatment is highly subjective and prone to judgement which can cause a distorted result. This provides a possibility for manipulation by providing results that support the needlessness of impairment. The study by Filip, Jeanjean, and Paugam (2014) indicates that determining the current fair value of goodwill relies on assumptions made by the management regarding the company's future that are difficult to verify and audit.

The result of an impairment test can be manipulated further by the use of cash generating units. According to IAS 36 paragraph 80, the goodwill acquired from a business combination shall be allocated to one or more cash generating units. Thus, by analysing the earning capacity of the acquired entity, goodwill can be distributed to various cash generating units. Then cash flows received by the units will be appointed to goodwill, too. Cash generating units can be problematic as they are merely constructs created by management. Business plans and cash flow forecasts are then produced for these units from which net present values are computed (Ford, 2018), meaning the values are based on arbitrary judgements. In addition, an objective market value for a cash generating unit does not exist because it is simply a made-up construct.

The value of goodwill is highly important to company executives. It is a determinant of accumulated and realised profits in the balance sheet that affects the distributable reserves that determine the size of dividend payments

(Ford, 2018). Moreover, dividend payments often determine the size of executive bonuses. Thus, management may have a conflicting interest when assessing whether goodwill is impaired. They will personally benefit more if they can convince the auditor that the value of goodwill has not decreased. This is supported by a study by Ramanna and Watts (2012, cited in Filip, Jeanjean, and Paugam, 2014) that found that 69 percent of companies with market indications of impaired goodwill reported no impairment of goodwill.

### 5.3 IAS 2 Inventories

According to IAS 2, inventories are defined as assets that are held for sale, in the process of production for sale or materials used in the production process (International Accounting Standards Board, 2003). Inventories are always classified as current assets; thus, non-current assets held for sale must be distinguished from inventories.

In order to fulfil the purpose of acquiring inventory, which is to sell them at profit, the initial recognition of inventory shall be at cost as stated in IAS 2. The initial measurement of inventory must be at the lower of cost and net realisable value. As for subsequent measurement, inventory can be accounted for by using either period or perpetual methods. The difference between the two is that whereas for the periodic method the amount of inventory is determined by operating a physical count where the number of units is multiplied by a cost per unit, the perpetual method ensures that inventory records are updated each time a transaction affects the volume of inventory (Blystone, 2021).

The net realisable value of inventory is estimated by subtracting the estimated costs of completion from the selling price in the ordinary course of business (Picker, et al., 2019: 237). The estimated net realisable value determines whether inventory must be written down. However, the net realisable value may fall below costs due to several reasons. Especially in the fashion industry the selling price may suffer from a sudden fall as a result of changes in trends. An

entity may also make changes to its marketing strategy and decide to manufacture and sell products at loss to make room for new products to launch. Miscalculations and other errors in purchasing or production may lead to overstocking. Furthermore, due to an increase in the estimated costs, the value of inventory may decrease.

A typical manipulation of IAS 2 occurs in the form of inventory overstatement (Jones, 2011: 50). Overstatement often arises as a result of management neglecting to take the physical count of inventory. The errors may be small, but they can cumulate into larger problems. The most common type of error occurs when the physical count of the inventory is incorrect. When the unit count is multiplied by the unit cost, the valuation of inventory is incorrect. It is also possible that the unit of measure may be wrong, for example, by recording an item as an individual item instead of a pair. Lastly, inventory error can be caused by a mistake in transferring the inventory item to another department. If the transfer fails to be updated, the value of inventory will be displayed at two places simultaneously.

Overstatement of inventory will affect other items in the financial statements, too, instead of just the inventory balance. The cost of goods sold will appear too low in the income statement as the actual costs of inventory do not realise (Bank, n.d.). In return, gross profit will appear too high along with operating income and net income. Furthermore, the entity will be required to pay more taxes. In the balance sheet, inventory too high will result in the value of current assets and total assets being too high. On the contrary, retained earnings and stockholder equity will be too high. Simply put, the whole balance of the financial statements will change as a result of the overstatement of inventory. This type of manipulation will be analysed more in-depth in the Ted Baker case.

## 5.4 IAS 1 Presentation of Financial Statements and the exclusion of extraordinary items

IAS 1 determines how financial statements shall be presented (International Accounting Standards Board, 2007). According to the standard, the financial statements must “present fairly” the financial position, financial performance, and cash flows of an entity. Another important factor is that entities must use accrual-based accounting for all financial reporting except for cash flow statement. This is essential as it affects the timing of recognising incomes and expenses.

In addition to the required items, additional line items, headings, and subtotals may be needed to fairly present the entity’s financial position as stated in IAS 1 paragraph 55. The inclusion of these items may help users to understand the entity’s performance and promote consistency from one financial year to another. They can also assist in making forecasts about future earnings because such items may vary in frequency and the extent to which they occur in. However, currently these items cannot be presented as “extraordinary items” in the income statement or in the notes. Previously, “extraordinary items” were defined as income or expenses that were non-recurring and did not arise from the ordinary activities of the business (Picker, et al., 2019: 487). This had allowed reporting items as extraordinary although they can be considered to result from normal business activities.

Extraordinary items are excluded from the IFRS because the term does not provide enough insight into the nature of the activity that has occurred. Moreover, it may remain unclear for users whether the item is ordinary instead. As a means to provide a more truthful view of the entity’s financial position, entities often report an adjusted earnings figure in addition to figures required by IFRS (IFRS Foundation, 2015).

IAS 1 provides flexibility when adding and defining new line items in the income statement. As a result, companies often include subtotals, such as “operating profit” or “EBIT” before profit or loss in the income statement (PwC, 2007). If

these subtotals are included in the statement, they must be consisted of line items presented under IFRS, they must be transparent, and presented consistently from period to period and shall be given no special treatment. However, by studying the annual reports as a whole, it may be distinguished that such non-IFRS subtotals can be emphasised in other sections of the report. Evidence of such practices are presented in the case of Thomas Cook.

## **6 Accounting manipulation case studies**

In this section, case studies are investigated. The cases are shortly introduced while focusing on the accounting manipulation itself. The manipulation is linked to the particular standard while expanding on what has happened. The executive remuneration schemes of each case company are elaborated to distinguish whether they show indications of personal benefits realised through accounting manipulation.

### **6.1 Carillion**

#### **6.1.1 Overview**

Carillion was the second largest multinational construction firm in the UK before its collapse in January 2018. At its collapse, it had only £29 million in cash and over £7 billion in debts and other liabilities (Wylie, 2020). The crisis became evident in July 2017 at Carillion's first profit warning. It was revealed that the revenue already booked for the period would not be realised, resulting in the numbers being out by £845 million (Bishop, 2018). This section will analyse Carillion's accounting practices regarding its revenue recognition and treatment of goodwill.

Carillion had multiple acquisitions since 2006 including the acquisition of Mowlem, Alfred McAlpine, and Eaga which boosted the amount of goodwill in

the balance sheet while ignoring impairments (House of Commons, 2018). The company aimed to become a multiservice provider by providing other services related to construction, too. These services included cleaning, catering, and maintenance. Since 2015 Carillion was growing its construction business even with some riskier contracts, intending to increase its revenue (Wylie, 2020). Moreover, the company practiced aggressive accounting practices for its construction contracts, where revenues were booked as soon as possible and payment terms of up to 120 days were negotiated. The questionable practices of revenue recognition and treatment of goodwill boosted executive bonuses and eventually led the company into liquidation.

### 6.1.2 Premature recognition of revenue from contracts

The accounting practices employed for revenue recognition on contracts were rather creative for Carillion. When studying the methods, it must be considered that at the time of Carillion's activities IAS 11 Construction Contracts was the effective standard. The connections to IFRS 15 Revenue from Contracts with Customers are evident, making the assumptions applicable to the current revenue recognition standard, too.

It was typical for Carillion to have large-scale construction contracts that could take years to deliver. The final payments could take a long time to be made. In order to provide an up-to-date value of their accounts, Carillion booked the value of contracts into the balance sheet as soon as possible after signing the deals (Wiley, 2020). In many instances, payments had not been made before this. According to accruals-based accounting, revenue should be recognised when it is earned, not received. This can be challenging in construction contracts as determining the level of completion is not easy. In order to determine the level of completion, the costs incurred to date are divided by the total forecast costs of the project (Zack, 2012: 13). That percentage is applied to the agreed contract price and revenue can be recognised. The weakness is that the emphasis is on estimations that can be manipulated.



KPMG noted in the 2016 audit report that Carillion would make changes to the estimates that would in turn affect the amount of revenue recognised (Sweet, 2018). Carillion aimed to make the estimates of final costs as low as possible to ensure that greater amounts of revenue can be recognised upfront. According to Carillion's internal auditor, Deloitte (cited in Sweet, 2018), the company had two processes for reviewing the estimates reported. One was a monthly management contract appraisal, and the other was a peer review that could challenge the financial, operational, and commercial performance of contracts. Interestingly, Deloitte found that management contracts appraisals reported higher profit margins than the peer reviews. KPMG auditor admitted Carillion had appraised riskier contracts in a rather optimistic manner (Shoiab, 2018), boosting their revenue.

This evidence supports the fact that Carillion did indeed manipulate the revenue recognition standard IAS 11 in their favour. Carillion recognised the revenue on its contracts according to the level of completion. The problem was that it used distorted estimations to make the amount of revenue greater while ignoring costs. Because of the similarities between IAS 11 and IFRS 15, similar manipulation could likely be used on IFRS 15, too.

### 6.1.3 Unimpaired goodwill

Carillion's treatment of goodwill was highly questionable. The total amount of goodwill by the end of 2016 was £1.6 billion (Carillion, 2017). The takeover of Eaga in 2011 illustrates the means of how Carillion overstated their goodwill. The acquisition cost of the takeover was recorded at £306 million, and the assets acquired had a goodwill value of £329 million (Wiley, 2020). Thus, the goodwill recorded was more than 100 percent of the purchase price. Carillion did not impair the value of goodwill in the years following the acquisition. Eaga, named as Carillion Energy Services after the takeover, suffered from a decrease in value as its revenue was only £43 million (Wylie, 2020).

Furthermore, the costs of the takeover had increased to £350 million. Despite these alarming signs of declining value, goodwill was not impaired.

The value of goodwill is often maintained at the same level because it is possible due to cash generating units as described in IAS 36 Impairment of Assets. The net present values of these constructs are mere predictions that are easy to manipulate into looking better (Ford, 2018). As a result, the chance of an impairment decreases. It requires a lot of effort from the auditors to question the numbers. A sensitivity analysis was conducted on Carillion's earnings forecasts and valuation assumptions for the relevant cash generating units (Brown, 2018). The auditor, KPMG, determined that no impairment was required. This indicates that Carillion's forecasts were highly incorrect and misleading.

Goodwill includes estimates of customer loyalty, brand reputation, the importance of market share gains, and other positive money-value estimates. These estimates are based on predictions on future profits that are hoped to realise through an acquisition (Ford, 2018). The Eaga acquisitions had alarming signs from the beginning that should have indicated the impairment of goodwill. Changing the name from Eaga to Carillion Energy Services had an inevitable negative effect on the value that should have been considered in addition to decreasing revenue.

Another sign of concern since the acquisition of Eaga was that the amount of disclosed goodwill remained at least at 84 percent of Carillion's enterprise value (Brown, 2018). As presented in Figure 4, in the years 2011, 2015, 2016, and 2017 the book value of goodwill exceeded the total enterprise value of the company.

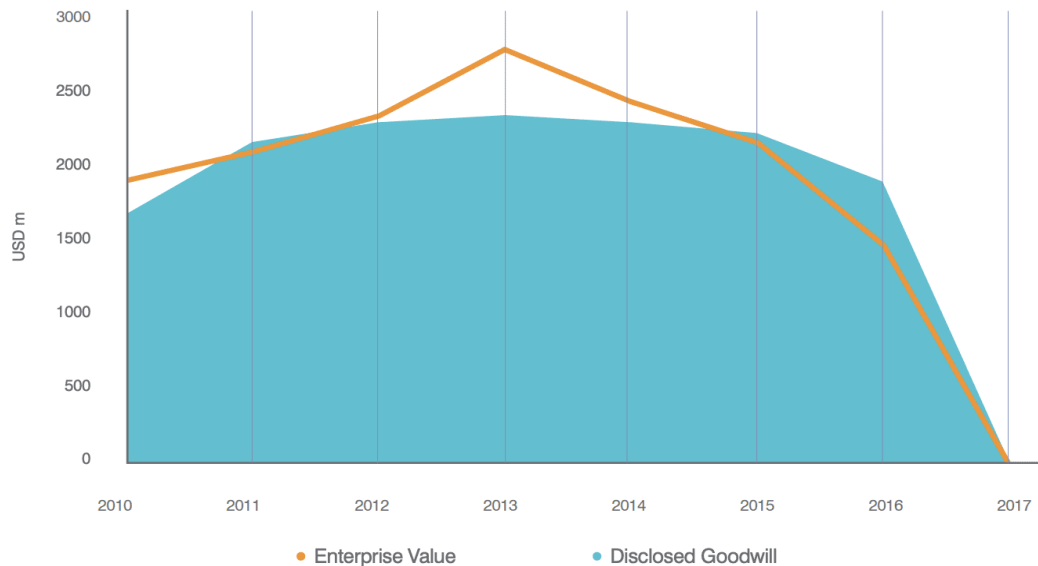


Figure 4. Carillion's historic goodwill and market enterprise value (Brown, 2018).

In comparison, Brown states that “the average share of market enterprise value disclosed as goodwill for the global set of trading companies between 2011 and 2017 was a mere 6 percent” (2018). The difference between Carillion and the average value is drastic and it indicates that an impairment would have been required.

It is evident that Carillion's management was incentivised by personal motives and investor satisfaction. Had Carillion been impairing its goodwill, its distributable reserves would have decreased, and dividend payments would have been much smaller. In 2015, Carillion had £373 million in shareholders' funds that enabled a dividend payment of £77 million. If goodwill had been written down, Carillion could have only paid a dividend of £44 million (Wiley, 2020). This would have had a negative impact on market confidence. For the management, it is beneficial to maintain dividend payments at a high level as it indicates business achievements. Dividend payments determine the number of executive bonuses. Thus, the higher the dividend payments, the bigger the bonuses. For instance, in 2011 the earnings of the Carillion top three executives increased 43 percent on 2010 earnings (Wiley, 2020), following the Eaga acquisition.

#### 6.1.4 Executive remuneration

The total remuneration of Carillion's executives showed an upward trend in the last five years of Carillion's operations. In 2012, the CEO Richard Howson's total remuneration was £791,000 while in 2017 it had almost doubled to £1,510 million. Over the same period, shareholders were paid £357 million in dividends although cash generated from operations was merely £159 million (Ford, 2018). In those five years, annual performance bonuses were rewarded every year except for 2012. An exceptional element to Carillion's remuneration scheme was that it did not require a threshold performance for metrics other than those related to cash (Carillion, 2017). Hence executives could be paid bonuses merely based on their individual, non-financial performance of which measures are prone to subjectivity.

The average bonus for the chief executive officer was 41,3 percent of base salary and for the chief financial officer 41,2 percent based on a calculation of bonus payments between 2016 and 2011. The bonus figure of 2016 was paid fully in cash to the CFO, Adam Smith, contrary to normal company protocols (Wylie, 2020). Adam Smith was retiring from the board on 31 December 2016 (Carillion, 2017) but it may not fully explain the total bonus being paid in cash instead of the normal 50 percent cash and 50 percent deferred shares policy. In addition to annual bonuses, long-term incentive awards were rewarded in 2015 and 2016 as shares of Carillion with a holding period of two years. This enabled selling the shares in 2017 before the profit warning decreased the share price.

The annual bonus was based on specified performance targets. The measures include financial and non-financial KPIs. As for 2016 bonuses, the total percentage awarded was solely based on non-financial KPIs. Moreover, in 2016 and 2017 the Carillion remuneration committee wanted to be able to pay larger bonuses to executives (Davies, 2018). The permission for this was not given. While malus and clawback provisions were included in the remuneration policy, they were highly limited to restricted circumstances. These circumstances did not truly allow the clawback of bonuses paid in cash at all (Deloitte, 2017).

Thus, the policy did not allow the clawback of bonuses already received at the moment of collapse.

It appears that Carillion's remuneration scheme was designed to reward executives as much as possible. While Carillion was not performing well for multiple years before its collapse, the remuneration scheme was focused on measures that excluded vital financial information. Applying accounting manipulation practices was most likely beneficial to the directors as they were able to gain personally, too. In comparison to other case companies, Carillion's remuneration scheme was ruthless.

## 6.2 Ted Baker

### 6.2.1 Overview

Ted Baker has had its fair share of difficulties from profit warnings to allegations of inappropriate behaviour towards staff. In December 2019, it appeared that the fashion retailer had overstated the value of inventory on its balance sheet by £58 million (Shabong, 2020). The overstatement was initially estimated to be £25 million which was then revised as a result of an independent review. This implied that the value of stock was overvalued by 35 percent (Stevenson, 2020 cited in Jolly, 2020). The possible reasons for overstatement are studied in more detail as well as the effects on executive remuneration.

### 6.2.2 Inventory overstatement

The reasoning for the overstatement was suggested as either Ted Baker having included physical stock that did not exist or placing too high a value on stock (McCormick, 2020). Overvaluation would suggest that the supply of stock would have been less than it was bought for. On the other hand, missing stock would indicate weakness in control. Ted Baker addressed the reasons for the inventory overstatement afterward in their annual report for 2019/20. The

overstatement was caused by inappropriate cost values attributed to inventory, stock that did not exist, and unadjusted stock figures in previous calculations (Ted Baker, 2020). Thus, the expected reasons appeared to be correct although failed to understand the depth of the problem.

Ted Baker disclosed information regarding its inventory on its 2018/19 annual report that shows awareness of possible risks related to inventory. It was stated that inventory values are calculated as the lower of cost and net realisable value according to IAS 2 Inventories while using the directors' knowledge and experience in the fashion industry. The volatility of the fashion industry's sales due to changing consumer behaviour and demand that heavily follows the current trends could have been better recognised (Sikka, 2020). The risk of the cost of inventory exceeding its net realisable value was thus possible. Such risks were addressed by focusing on testing the inventory stock counts, analysing historical trends, and finding ways to sell older season inventory. These controls appeared to be not as effective as planned. The report stated that the management had not been aware of any misstatements to achieve an enhanced presentation although it is now known that such misstatements did exist.

The inventory management issues could have been acknowledged prior to having to write down such an amount at once by using more prudent accounting methods. Ted Baker's accounts show that between January 2016 and 2019, finished goods have increased by £99 million, from £117 million to £216 million. Using the inventory turnover ratio that shows the rate at which a company replaces inventory in a given period as a result of sales, the finished goods inventory should have increased to only £165 million instead of the £216 million in 2019 (Taylor, 2020). The additional £51 million in the accounts raises concerns. However, the company seemed to learn from its mistakes as the approach to estimating the carrying value of stock was reviewed in the restatement process (Ted Baker, 2020). More prudent accounting methods were adopted to provide more accurate figures in the future.

Based on the study on IAS 2 Inventories, the weaknesses lie where there is a possibility for estimation. An opportunity for manipulation occurs when using the periodic method. As the method requires conducting a physical count periodically that does not change until the next count, there are a lot more possibilities for error. These expectations are in accordance with the findings of Ted Baker's inventory overstatement case. Based on the findings it can be assumed that it is often the combination of various errors that result in an overstatement like this.

### 6.2.3 Executive compensation

Whether the inventory overstatement resulted in higher executive bonuses may be revealed through the annual reports. The benefit of overstating inventory is that it increases profits. By flattering the image of the company's affairs, the stock price would increase, and higher bonuses could be paid. According to Ted Baker's remuneration policy, senior executives are incentivised to generate value for shareholders. Performance metrics used aim to create a strong link between senior management remuneration and business performance (Ted Baker, 2019). The incentives are used to motivate and reward the success of the group.

Based on the annual report of 2018/19 short-term bonuses were not paid to executives as the financial targets set at the beginning of the period were not met. Unlike other case companies, Ted Baker does not disclose specific information on the performance metrics used to measure annual bonuses. This may be linked to the study by Bachmann, et al. (2019) which suggested that not disclosing such information may result in a poor performance in the subsequent years. However, the targets of long-term incentive plans were met in both years, resulting in additional compensation as presented in Figure 5. There was neither annual increase in the basic salaries for the period. In 2020 bonuses were not paid either as the inventory overstatement had been announced (Ted Baker, 2020).

**DIRECTORS' SINGLE TOTAL FIGURE OF REMUNERATION (AUDITED)**

PERIOD ENDED 26 JANUARY 2019	SALARY	TAXABLE BENEFITS <sup>1</sup>	PERFORMANCE RELATED BONUS	LONG-TERM INCENTIVE PLANS <sup>2</sup>	PENSION	TOTAL 2019
	£'000	£'000	£'000	£'000	£'000	£'000
<b>EXECUTIVE</b>						
Ray Kelvin <sup>1</sup>	459	22	-	530	-	1,011
Lindsay Page <sup>2</sup>	441	24	-	506	55	1,026
<b>NON-EXECUTIVE</b>						
David Bernstein	85	-	-	-	-	85
Ron Stewart	60	-	-	-	-	60
Andrew Jennings	55	-	-	-	-	55
Anita Balchandani <sup>3</sup>	-	-	-	-	-	-
Jennifer Roebuck	55	-	-	-	-	55
Sharon Baylay	34	-	-	-	-	34
	1,189	46	-	1,036	55	2,326

<sup>1</sup> Ray Kelvin resigned as Chief Executive Officer on 4 March 2019.

<sup>2</sup> Lindsay Page was appointed as acting Chief Executive Officer on 7 December 2018. Lindsay will receive a salary increase of £20,000 to £460,000 per annum for the period he is acting in this capacity, backdated to 7 December 2018. This has been included within his remuneration for the year ended 26 January 2019.

<sup>3</sup> Anita Balchandani resigned as Non-Executive Director on 19 February 2018.

<sup>4</sup> Benefits comprise private medical insurance and car benefits.

<sup>5</sup> The value of LTIPs included in the Directors' single total figure of remuneration table above relates to Award 3 of the 2013 LTIP which vested to 85% of maximum on 29 April 2018. The value included is calculated using the number of options that vested at the share price on the date the award vested (£26.70), less the cost of exercise (nominal cost of 5p per ordinary share).

Figure 5. Directors' remuneration in the financial year ended 26 January 2019 (Ted Baker, 2019).

The figures of previous years present a very similar image. Executives have not been rewarded annual performance bonuses after 2016. Instead, long-term incentive plans have been rewarded annually since then. The amount of annual bonus paid before 2016 is relatively high; on average 90 percent of base salary. It is concerning that in the years before the inventory overstatement, there have been large annual performance bonuses paid. However, the amount of the total remuneration and the number of bonuses is not alarmingly high in comparison to other case companies. Moreover, the Ted Baker remuneration policy states that annual bonus and long-term incentive plans are both subject to malus and clawback provisions. This option was not utilised in the case of inventory overstatement.

The executives acting at the time of the scandal resigned shortly after. The possible personal gains of overstating inventory may have materialised in previous years when annual bonuses were rewarded. Although the long-term incentive awards were rewarded to them between 2017 and 2019, they lapsed after the resignation (Ted Baker Plc, 2020). Any other compensation related to their leave was not awarded, either. These actions decreased the possible personal gain received.



## 6.3 Thomas Cook

### 6.3.1 Overview

Founded in 1841, Thomas Cook was one of the oldest travel firms before going into liquidation in 2019 (Collinson, 2019). The company was struggling to adapt and stay competitive in a nascent industry where competitors offered flexible travel options, other travel-related services, and low-cost airlines. At its collapse, Thomas Cook had over £1.7 billion of debt (Hernandez, 2020). The company's creative accounting techniques caused its profit to appear greater and executive bonuses bigger. The amount of goodwill possessed – more than £1 billion – was alarming and many costs were classified as one-off costs that were cut out of financial statements. The focus of this section is to study the treatment of those one-off costs. The remuneration scheme will be studied to see whether the creative accounting practices assisted executives in receiving higher bonuses.

### 6.3.2 Treatment of extraordinary items

It is typical for companies to cut out one-off costs to provide a true reflection of their performance. One-off costs or exceptional costs refer to those costs that are infrequent and unusual in nature compared to the ordinary business in that they are disclosed separately (Tuovila, 2020). By the use of one-off costs, underlying profits can be cast to appear better as the costs are not expected to recur. Thomas Cook, however, classified regular costs as “exceptional one-offs” or “separately disclosed items”, despite the auditor advising against it (Chapman, 2019). This had a huge impact on the appearance of Thomas Cook's earnings as presented in Figure 6. Underlying profit appears greater than operating profit as it is not impacted by the stripped-out one-off costs in all years. In the year 2018, the underlying EBIT is £250 million while the statutory equivalent is only £97 million, resulting in a difference of over £150 million.

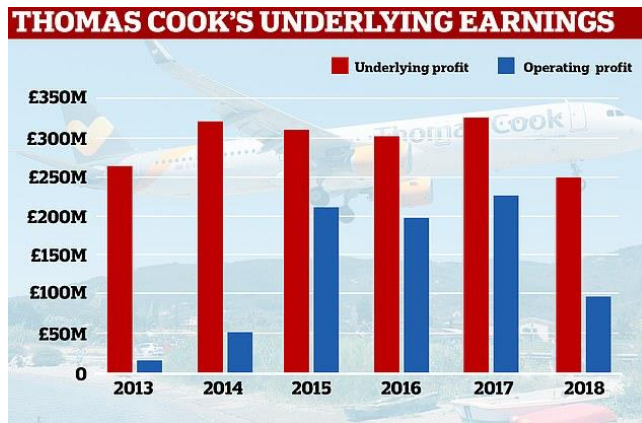


Figure 6. Thomas Cook's underlying profit (EBIT) in comparison to operating profit (Adams, 2019).

The IFRS do not define the measurement or recognition of separately disclosed items. Instead, IAS 1 permits the use of additional line items and subtotals as a method of presenting a “true and fair” view of the business. This enabled the use of separately disclosed items and the use of underlying profit for Thomas Cook. Determining the appropriateness of such classification requires the considerate use of judgement. This makes the use of such items prone to manipulation as it requires to use of judgement outside the standards.

Moreover, the underlying profit figure was emphasised in great detail in their 2018 annual report as the main figure presenting profit (Thomas Cook, 2018). Figure 7 presents the numbers presented on Thomas Cook's annual report for 2018 on page three. Underlying EBIT is emphasised whereas profit for the period is left without a mention. The fine print at the bottom only tells the reader that underlying EBIT does not include costs that affect the profit.

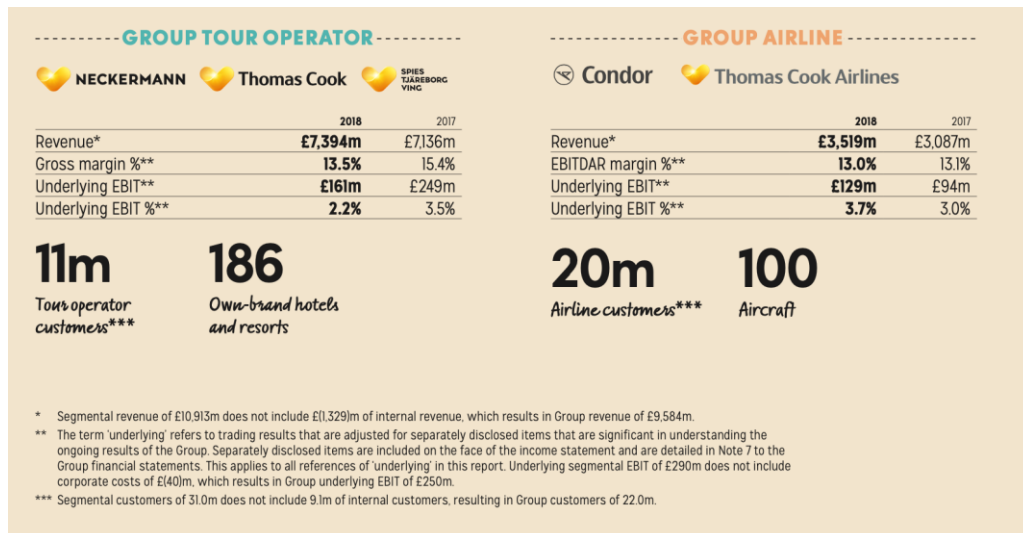


Figure 7. Thomas Cook group at glance in 2018 (Thomas Cook, 2018).

Thomas Cook's practices were highly questionable and misleading to the users of the financial statements. Highlighting non-statutory figures in the annual report can increase misunderstanding of the performance of the business. Considering the auditor's advice against this accounting practice, Thomas Cook's practices appear to deliberately conceal the underlying business problems.

### 6.3.3 Executive compensation

The accounting practices allowed the company to pay its executives large bonuses that would not have been possible otherwise because of the amount of debt (Hodge, 2019). The bonuses were paid according to Key Performance Indicators (KPIs) that were not based on standard accounting figures. One of the KPIs was Group underlying Earnings Before Interest and Tax (EBIT) (Leaver and Haslam, 2019). The use of underlying figures excluded separately disclosed items from the KPI calculation, meaning the 2017 result appeared £99 million better than it would have with the costs included. The calculation also excluded finance costs which were high in Thomas Cook due to high gearing.

Thomas Cook's chief executive officers were paid large sums of money in their years of being on top. The remuneration policy of the company aimed to

incentivise and reward growth, cash management, customer service, colleague engagement, and long-term value creation for shareholders (Thomas Cook, 2018). These KPIs provided a link to the company strategy.

In the financial year 2018 annual bonuses were not rewarded to executives as the challenging trading conditions were acknowledged. However, the years before that were highly lucrative to executives. Figure 8 provides insight into the total remuneration paid to the company CEOs. The CEO has received an annual bonus annually except for the years 2018 and 2014. The amount of annual bonus has been on average 60,7 percent of base salary. In 2016 when the company's last CEO Peter Fankhauser came into the job, the company was already failing (Farmbrough, 2019). Indicators of the upcoming failure can be seen in the balance sheet of years 2012 to 2018 where liabilities increase annually. It is concerning that despite the warning signs, executives could be paid in such amounts.

The table below shows the pattern of remuneration of the CEO during this period.

	CEO	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
CEO single figure of remuneration	Peter Fankhauser <sup>1</sup>	n/a	n/a	n/a	n/a	n/a	n/a	£4.296m	£1.209m	£1.837m	£1.024
	Harriet Green <sup>2</sup>	n/a	n/a	n/a	£717k	£2.855m	£1.046m	£248k	n/a	n/a	n/a
	Sam Weihagen <sup>3</sup>	n/a	n/a	£153k	£1.171m	n/a	n/a	n/a	n/a	n/a	n/a
	Manny Fontenla-Novoa <sup>4</sup>	£2.996m	£2.322m	£1.008m <sup>5</sup>	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Group Bonus Plan payout (as % maximum opportunity)	Peter Fankhauser	n/a	n/a	n/a	n/a	n/a	n/a	69%	22%	78%	0%
	Harriet Green	n/a	n/a	n/a	n/a	100%	0%	0%	n/a	n/a	n/a
	Sam Weihagen	n/a	n/a	0%	23%	n/a	n/a	n/a	n/a	n/a	n/a
	Manny Fontenla-Novoa	96%	80%	0%	n/a	n/a	n/a	n/a	n/a	n/a	n/a
PSP vesting (as % of maximum opportunity)	Peter Fankhauser	n/a	n/a	n/a	n/a	n/a	n/a	70% <sup>6</sup>	0%	0%	0%
	Harriet Green	n/a	n/a	n/a	n/a	n/a	n/a	See below <sup>2</sup>	n/a	n/a	n/a
	Sam Weihagen	n/a	n/a	0%	0%	n/a	n/a	n/a	n/a	n/a	n/a
	Manny Fontenla-Novoa	68%	0%	0%	n/a	n/a	n/a	n/a	n/a	n/a	n/a

The table above shows the prescribed remuneration data (as shown in the left-hand side column) for the Director(s) undertaking the role of CEO during each of the last ten financial years.

**Notes:**

<sup>1</sup> Peter Fankhauser was appointed CEO on 26 November 2014, and has been employed in the Group since 1 May 2001.

<sup>2</sup> Harriet Green stepped down as CEO on 26 November 2014 and remained a Director until 31 December 2014. In addition to the single figure shown, a proportion of Harriet Green's 2012 PSP award vested following her departure with 4,115,721 shares vesting under this award.

<sup>3</sup> Sam Weihagen was appointed CEO on 3 August 2011 and remained in post until the appointment of Harriet Green on 30 July 2012.

<sup>4</sup> Manny Fontenla-Novoa stepped down as CEO on 2 August 2011.

<sup>5</sup> The single figure for FY11 for Manny Fontenla-Novoa excludes his termination payment, which was a total of £1.2m (in respect of contractual entitlements to base salary, pension allowance and benefits in lieu of notice).

<sup>6</sup> Relates to the June 2012 PSP and CDIP awards and the September 2012 PSP award representing the full value received.

Figure 8. CEO remuneration of Thomas Cook between 2009 and 2018 (Thomas Cook, 2018).

In the last 10 years, Thomas Cook has had 4 chief executive officers. This makes it highly challenging to interpret the company's remuneration scheme. The constant personnel changes raise concerns over the company's practices

and could have referred to problems in the company. As the bonuses were rewarded to executives years before the collapse, it can be interpreted that decisions made at that time appeared profitable in the short term, flattering the financial result. Bonuses were collected and the company was let to collapse.

## 6.4 Tesco

### 6.4.1 Overview

Tesco's accounting scandal in 2014 involved overstating revenue. Six months' profits had been overstated by £250 million as a result of booking rebate payments from suppliers based on overoptimistic estimates (Barrett, Agnew and Felsted, 2014). As the UK's grocery market is so competitive, it is typical for big brands to compete for the best spots on the shelves. Suppliers pay Tesco rebates for reaching a certain level of sales or for support for promotions. Tesco must estimate halfway through the year the value of rebates it will receive in the whole year. This practice can be challenging especially if the trading environment changes, and those changes are not considered in the estimations.

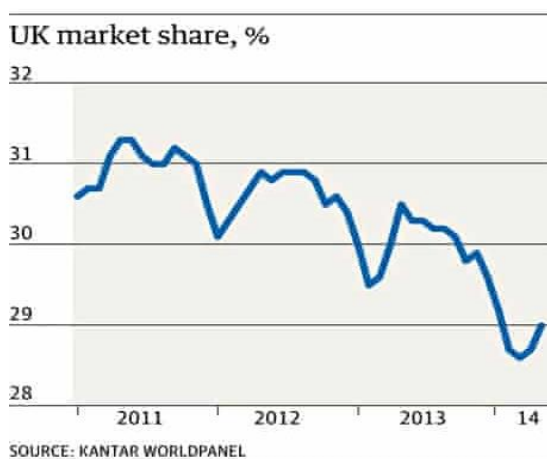


Figure 9. Tesco's UK market share from 2011 to 2014 (Butler and Farrell, 2014).

Tesco had been struggling already before this incident due to losing its market share to competitors with lower prices, such as Aldi, Lidl, and B&M Stores. As pictured in Figure 9, Tesco's market share has decreased from over 30 percent down to almost 28 percent. These changes in the trading environment had likely been ignored in the making of rebate estimates. Whether this had a positive effect on executive compensation will be studied in this section, too.

#### 6.4.2 Overestimation of commercial income

Rebates are estimated so that managers' expectations on receivable rebates during the first half are inquired. The managers may not necessarily need to provide evidence for their assessment which increases the risk of being overly optimistic. The risk increases if the rebate numbers are linked to commission or bonus payments.

According to David McCarthy, the head of European consumer retail research at HSBC, it is likely that the year 2014 rebates estimated were based on historic trends while ignoring the decreasing volume of sales (Barrett, Agnew, and Felsted, 2014). It is worth noting that it is unsure how far the misjudgements date back in reality. The signs suggest that overestimations may have happened over a longer period of time. In June 2010, an analyst from Citi bank stated Tesco's accounting to be consistently aggressive. They suggested that if Tesco applied more "standard" accounting methods, its profits before tax would have fallen by £64 million (Ahmed, 2014). Furthermore, they suggested that Tesco's value does not look satisfactory if looked at on more comparable accounting assumptions. Tesco's accounting policies were not insinuated to be inappropriate but that they were applied in a way that would flatter Tesco's performance.

Booking rebates is a questionable business as it is based on estimates made by individuals. Thus, it is highly subjective. The rebates are based on sales which can only be estimated beforehand and can be subject to unforeseen changes. Furthermore, rebate programmes have generally lasted around six months for Tesco hence the payments could total up to billions of pounds (Bergin, 2014).

That said, the size of the revenue write-down is not surprising. While booking rebates prematurely aims to provide a true and fair view of the business, it provides an opportunity to manipulate the accounts and book hope values. Critical judgement and discretion should be used when determining the number of rebates prematurely. The risks of booking supplier rebates have been acknowledged by auditors, too.

Rebates are booked according to IFRS 15 Revenue from Contracts with Customers. At the time of the case, IFRS 15 was not effective, and thus IAS 18 Revenue was applied. Under IFRS 15, volume rebates are a type of variable consideration (Picker, et al., 2019: 94). The amount of consideration is simply an estimate which makes it another weakness in the standard that enables manipulation.

#### 6.4.3 Executive remuneration

Tesco's remuneration scheme may provide insight into whether executive compensation was influential in the decision making of booking revenue. Tesco's short-term performance measures at the time were based on profitability (50 percent), strategic financial performance (26 percent), and strategic non-financial performance (24 percent) (Tesco, 2014). The remuneration arrangements are designed so that they follow a pay-out curve, with the maximum award opportunity being 250 percent of salary. Figure 10 presents the amount of remuneration paid to the CEO in the last five years prior to the scandal. The annual performance bonus was last paid in 2012 which Philip Clarke rejected as had been appointed as the CEO in the same financial period (Tesco, 2014). In 2010 and 2011 when the annual bonus was paid to the CEO, it was approximately 223 percent and 190 percent of the base salary which are half paid in cash and the other half in deferred shares.

#### Six year remuneration history

	2009/10	2010/11	2011/12	2012/13*	2013/14	2014/15	
	Sir Terry Leahy	Sir Terry Leahy	Philip Clarke	Philip Clarke	Philip Clarke	Philip Clarke	Dave Lewis
CEO single figure of remuneration (£'000)	7,100	7,150	4,595	1,280	1,634	764	4,133
Annual bonus vesting (% of maximum award)	89%	75%	0%	0%	0%	0%	0%
PSP vesting (% of maximum award)	82.7%	75%	46.5%	0%	0%	0%	0%
Share option vesting (% of maximum award)	100%	100%	100%	0%	n/a	n/a	n/a

\* Philip Clarke elected not to take a bonus for 2011/12. Other Executive Directors received a bonus of 13.54% of maximum.

Figure 10. Six-year remuneration history of Tesco CEOs (Tesco, 2015).

Tesco's remuneration scheme is challenging to interpret because of the personnel changes. Between 2010 and 2015 Tesco has had three chief executive officers. Changes in the total remuneration can also be a result of that and reflect the level of experience. However, it is conspicuous that the base salary of the CEO has remained at over £1 million until 2014, especially in comparison to other case companies' CEO's base salary. It can be argued that being Tesco's CEO has been highly rewarding although the company has not been performing well.

In the years from 2013 to 2015, Tesco's poor financial performance was acknowledged in the remuneration. Annual bonuses were not paid as the satisfactory level had not been achieved, and any long-term performance plan awards lapsed (Tesco Plc, 2015). The acting executives at the time of the scandal soon stepped down. This resulted in them not receiving bonuses and share options received in the previous periods lapsing. Both executives were, however, paid a generous termination payment. Tesco's Remuneration Committee also has the opportunity to claw back both cash bonus payments and share plan awards, but this action was not taken in this case.

It is uncertain for how long the overstatement of revenue has continued. Based on this evidence, aggressive accounting practices may have been useful in order to receive personal gain. A degree of confluence of executive remuneration and accounting standard manipulation can be seen in this case although it is not as evident as in the other cases.



## 7 Results

This section presents the discovered findings based on the analysis of IFRS Standards and case studies. The degree of manipulations is addressed along with the remuneration schemes of case companies.

The standards studied in this paper were selected and identified based on the initial case study research. Based on this sample, it is evident that the IFRS Standards do comprise an element of flexibility. It can be assumed that the standards studied in this paper are not the only standards with flexible elements. While flexibility is justified as a means for companies to provide a true and fair view of their financial position, its importance is challenged by its misuse. Those who wish to improve an entity's financial statements by unethical means may take advantage of that flexibility.

Based on the analysis, it can be determined that whenever a standard requires the use of estimates or judgement, there is a higher risk of manipulation. The elements of flexibility of IFRS 15 lie in determining the transaction price if it includes a variable consideration. Another element of flexibility is in the measurement of satisfaction of performance and particularly when a performance obligation is satisfied over time. The issue with IFRS 3 is in the measurement of consideration that requires the use of judgement. As for IAS 36, the use of cash-generating units and providing distorted results for the impairment tests is problematic. The problems with IAS 2 arise from the overvaluation of inventory as a result of errors in the physical count. IAS 1 provides flexibility by allowing the use of additional subtotals and other non-statutory line items. This may distort the actual financial results.

The manipulation of the standards appears through the case studies. Table 1 presents the manipulations in each case. In all cases, the figures were manipulated to flatter the result of the period, resulting in the overstatement of items. The possibility of understating the results was not examined in this paper yet it should be considered that such cases also exist. It must be acknowledged

that the manipulation of the standards in the cases is not limited into the ones analysed in this study. It is likely that other standards have also been used to manipulate the companies' accounts.

Company	IFRS Standard
Carillion	IFRS 15 Revenue from Contracts with Customers
	IFRS 3 Business Combinations
	IAS 36 Impairment of Assets
Ted Baker	IAS 2 Inventories
Thomas Cook	IAS 1 Presentation of Financial Statements
Tesco	IFRS 15 Revenue from Contracts with Customers

Table 1. IFRS Standards each company has manipulated.

The annual performance bonus payments made to CEOs in the year of the scandal, or the year of the latest annual report available and five years earlier are presented in Table 2. This highlights the issue of paying bonuses to executives the years before accounting manipulation becomes public. In all cases, apart from Carillion, in the year of the accounting manipulation being disclosed bonus payments were not made. The performance of the year did not allow the payment of bonuses. However, in previous years large bonuses were rewarded to executives. As a result of manipulation in the previous years, performance appears better. The benefits of manipulation have been received by the time accounting manipulation is revealed. Furthermore, the remuneration policies studied put emphasis on non-financial metrics in addition to financial metrics when determining annual bonuses. Some financial metrics were merely non-statutory KPI figures, such as underlying EBIT. As a result, factors not based on IFRS are able to influence the amount of compensation.

**Annual bonus payments to CEOs**

The year of scandal and five years prior

	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
<b>Carillion</b>	377 000	-	203 000	246 000	293 000	245 000
	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
<b>Ted Baker*</b>	375 000	223 000	-	-	-	-
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>Thomas Cook**</b>	1 785 000	-	605 000	236 000	837 000	-
	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
<b>Tesco***</b>	3 124 000	2 714 000	-	-	-	-

\* Ted Baker's financial year from February to January

\*\* 2013 bonus payment relates to a 14-month-period

\*\*\* Tesco's financial year from March to February. CFO was paid annual bonus 2012, but CEO was not.

Table 2. Annual bonus payments made to CEOs in the year of the scandal (or the year of the latest annual report available) and five years earlier.

CEO turnover shall also be considered when analysing the bonus payments.

Table 3 presents the appointment dates and resignation dates of each CEO and CFO in the last ten years. This table provides evidence that the executive turnover has been relatively high around the event of manipulation and its disclosure. The only case company with a low turnover is Carillion. When Table 3 is compared with the annual bonus payments, it can be discovered that the succeeding CEO has not received bonuses. An evident example is the resignation of Tesco CEO Sir Terry Leahy succeeded by Philip Clarke whose annual bonus figures were zero for the years of acting as the chief executive. The change of CEO may also have influenced the company's performance poorly which has affected the bonus payments.

	CEO turnover			CFO turnover		
		Appointment	End date		Appointment	End date
<b>Carillion</b>	Richard Howson	2010	9.7.2017	Richard Adam	2007	31.12.2016
	Keith Cochrane	10.7.2017	15.1.2018	Zafar Khan	1.1.2017	15.1.2018
<b>Ted Baker</b>	Ray Kelvin	1997	4.3.2019	Lindsay Page	1997	10.11.2019
	Lindsay Page	7.12.2018	10.12.2019	Rachel Osborne	11.11.2019	9.12.2019
	Rachel Osborne	10.12.2019	-	David Wollfe	2.1.2020	-
<b>Thomas Cook</b>	Manny Fontenla-Novoa	2007	2.8.2011	Paul Hollingworth	2010	1.7.2012
	Sam Weihagen	3.8.2011	30.7.2012	Michael Healy	1.7.2012	31.12.2017
	Harriet Green	30.7.2012	26.11.2014	Bill Scott	1.1.2018	30.11.2018
	Peter Fankhauser	26.11.2014	23.9.2019	Sten Daugaar	1.12.2018	23.9.2019
<b>Tesco</b>	Sir Terry Leahy	1997	2.3.2011	Laurie Mcllwee	27.1.2009	4.4.2014
	Philip Clarke	2.3.2011	1.9.2014	Alan Stewart	23.9.2014	30.4.2021
	Dave Lewis	1.9.2014	1.10.2020			

Table 3. CEO and CFO turnover in case companies in the last 10 years.

Based on the evidence presented in this paper through analysis of the case companies' remuneration schemes, personal incentives appear to be common. While the cause and consequence cannot be determined through this study, the patterns in executive remuneration suggest there is a relation between remuneration and accounting manipulation. Large bonuses were paid to executives a few years prior to the disclosure in all cases, inflating their personal benefit. Often, long-term incentive awards were also vested to executives. Carillion was the only case company where annual bonuses were granted annually before its collapse. It is likely that these companies are not the only ones inflating the executive compensation. It can be assumed that if there is a possibility to increase personal benefit, the risk of manipulation increases.

It is worth considering how these incentives can be decreased. Assuming that the executive compensation may incentivise accounting manipulation, changes to compensation measurements should be reconsidered. The executive remuneration is often based on performance as a means to motivate for better performance, but the practice is controversial. Executives are rewarded for the company's good performance in the form of bonuses and long-term incentives, but they are also rewarded for poor performance as their base salaries and benefits remain at the same high level despite the performance.

Due to the limitations of this study, the gravity of the issue cannot be fully addressed. The flexibility within IFRS would require further investigation to determine the extent to which all of the IFRS Standards are flexible. In order to discover whether there is a causal relationship between executive remuneration and accounting manipulation, further studies should be conducted.

## **8 Conclusion**

The flexibility within the IFRS Standards provides opportunities for managers to manipulate the company's accounts. Based on the sample of five IFRS Standards it can be assumed that whenever a standard has an element of estimation or judgement, the possibility of manipulation increases because estimates are always subjective. As flexibility is in the nature of the IFRS, it is likely that other standards possess similar elements of estimations. The cases studied support the assumptions on accounting standards being manipulable.

While this study has focused on only a few selected accounting standards, it is likely that the case companies have applied other methods of manipulation, too. Accounting manipulation schemes are often complex and crafted by professionals with the aim to hide such features that could refer to accounting manipulation. Due to the limitation of this study, a limited number of aspects can be studied in relation to the case companies. Yet it is enough to highlight the gravity of accounting manipulation.

Executive remuneration and accounting manipulation generate an alarming combination. While the executive compensation aims to reward good performance, the outcome can be manipulated by manipulating performance. Each case study provides evidence on annual bonuses being distributed to executive officers in the years before the accounting manipulation become a public affair. Thus, manipulating the accounts has been beneficial to the executives.

Due to the flexibility in the accounting standards, the standards can be exploited to manipulate the accounts. As the manipulation inflates the company accounts, executives can be paid large bonuses for the time being. Once the manipulation cannot cover the financial difficulties anymore, bonuses are not paid any longer and soon the issue becomes publicly acknowledged. Executives are not often paid bonuses the year before manipulation becomes public, but the disadvantages to them are minimal as the money has already been earned in the previous years. Although companies have an option for malus and clawback provisions, these practices are not generally used because of the limitations that are set. Thus, it can be stated that accounting standard manipulation and executive remuneration are interdependent to a degree.

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