

Background and Effects of Creative Accounting Practices in the Health Sector in Latin America During the Pandemic Era

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Abstract

The COVID-19 pandemic marked a before and after for the global economy, and one of the most affected sectors was the health sector, where rising costs in medical care, protective equipment and infrastructure, coupled with a decrease in income from other regular services, led a large part of health centers such as public and private hospitals to resort to unethical accounting practices for the manipulation of their financial information (creative accounting). These events of financial depression and relaxation of controls during the health emergency allowed the creation of a "favorable" environment to distort financial statements through techniques such as premature recording of income, undervaluation of expenses, among others, to evade taxes and take advantage of the benefits imposed by governments to promote humanitarian aid and prioritize health care. The purpose of this article is to highlight the most common creative accounting practices that were applied in the health sector in Latin America during the COVID-19 pandemic and the consequent effects it had on the economy and on the governmental control of the countries in the region for the detection of these practices.

Keywords: Creative Accounting, Finance, Ethics, Corruption, COVID-19.

1. Introduction

At the end of 2019 and beginning of 2020, cases of COVID-19 became more frequent, which put the international community on alert, triggering several alerts of border closures, and other measures to counteract the spread of the disease without no success(Ciotti et al., 2020). Therefore, through the WHO (An Organization belonging to the UN), this health emergency was declared a Pandemic, which put the world, after almost a century, in indefinite quarantine between February and March 2020, causing several havoc not only at the health level, but at the social and mainly economic level worldwide.

The COVID-19 pandemic has tested the resilience of health systems around the world, and Latin America has been no exception. The region has faced unprecedented challenges, from shortages of medical resources and equipment to overloaded healthcare facilities.(World Health Organization, 2023). Amid this crisis, some healthcare institutions have turned to creative accounting practices, a controversial decision that has sparked ethical debates and concerns about transparency and financial integrity.

Creative accounting practices, also known as "charging," refer to the legal manipulation of financial reports to present a more favorable image of the financial condition of a company or institution.(Jones, 2010). These practices may include reclassifying items, changing accounting policies, or applying biased estimates and judgments.(Abed et al., 2022). While not illegal per se, they can be ethically questionable and, in some cases, can lead to misrepresentation of financial reality.

In the context of the COVID-19 pandemic, health institutions in Latin America have faced unprecedented pressure to maintain their operations and provide adequate medical care to the growing demand of patients.(Mojica-Crespo & Morales-Crespo, 2020). Some hospitals and clinics have experienced a significant decrease in revenue due to the cancellation of elective procedures and the reduction of non-essential services.(Ferrer, 2020). At the same time, they have had to face additional costs related to treating COVID-19 patients, acquiring personal protective equipment (PPE), and implementing stricter safety protocols.(Torres-Toledano et al., 2023).

In this challenging scenario, some healthcare institutions have resorted to creative accounting practices to artificially improve their financial situation and meet the requirements of lenders, investors or regulators.(Quijano Valencia, 2021). These practices may include overcapitalizing expenses, overstating assets, or understating liabilities and contingencies. However, these actions have been the subject of criticism and concerns from experts and control bodies. It is argued that creative accounting practices can undermine transparency and accountability, which in turn can erode public trust in the health sector. Furthermore, they can lead to inefficient resource allocation and management decisions based on inaccurate financial information.(Atrill & McLaney, 2021).

One of the main antecedents of creative accounting practices in the healthcare sector in Latin America during the pandemic has been the unprecedented financial pressure that these institutions have faced. Reduced revenues, additional costs, and the need to maintain a strong financial picture to attract financing and meet regulatory requirements have created incentives

to manipulate financial reporting.(Flynn et al., 2024). Another factor that has contributed to these practices is the lack of adequate supervision and regulation in some countries in the region. Weaknesses in regulatory frameworks and internal control systems have allowed some healthcare institutions to take advantage of legal loopholes and gray areas in accounting standards.(Aborisade et al., 2024).

Additionally, the complexity and uncertainty inherent in the pandemic has provided opportunities for healthcare institutions to make biased accounting estimates and judgments. For example, the valuation of assets and liabilities related to the treatment of COVID-19 patients or the estimation of the useful life of medical equipment purchased during the pandemic may have been subject to manipulation.(Zhang et al., 2024). The effects of creative accounting practices in the Latin American healthcare sector during the pandemic have been diverse and, in some cases, potentially harmful. First, these practices may have distorted the true picture of the financial situation of health institutions, which in turn may have led to inappropriate management and resource allocation decisions.(Abed et al., 2020).

Second, the lack of transparency and erosion of public trust in the health sector may have undermined pandemic response efforts and the credibility of health authorities.(Zhang et al., 2024). This may have hindered coordination and cooperation between different actors, as well as the population's acceptance and compliance with public health measures. Another potential effect of creative accounting practices is the distortion of competition in the healthcare sector.(Abed et al., 2020). Institutions that have resorted to these practices may have gained an unfair advantage over those that have maintained transparent and accurate accounting, which can lead to inefficient allocation of resources and a decline in the quality of health care. Furthermore, creative accounting practices may have had a negative impact on the ability of health institutions to access financing or attract investment. If these practices are discovered, they can seriously damage the reputation and credibility of the institutions involved, which can make it difficult for them to access external funding sources and ultimately affect their ability to provide adequate health services.(Adamikova & Corejova, 2021).

2. Creative accounting within the reality of the region

The growth of financial scandals for health sector entities in Latin America is notable. These events compromise its strengthening or existence, due to the deplorable ethical, social and economic consequences on patients, who, having no or unclear vision of the financial situation, make emotional and sometimes wrong decisions.(Calligaro et al., 2022). In these cases, when fraud comes to light, it triggers sanctions of various kinds and loss of credibility with its different stakeholders. Frauds against the different stakeholders, represented by the personnel in charge of determining the short, medium and long term policies in this matter, occur for different reasons, among them the most important lies in the financial pressure that the sector presents, caused by an insufficient number of resources, cost growth exceeding revenue growth, competition and inadequate efficiency and effectiveness in the use of these(Guillermo et al., 2022).

To deal with this situation, several of its managers have adopted the implementation with an appropriate concept called coherent and sustainable management and direction. Based on the background presented in the previous paragraph, which indicates that health sector entities adopt practices in order to manipulate financial information and comply with financial incentives or pressures, the authors hope to demonstrate that the use of creative accounting in Latin America is a common practice, and that the most common reasons are due to financial incentives or pressures and have a negative effect on the quality of financial information(Higuita Durango et al., 2021).

One of the main reasons why practices such as creative accounting occur in regions such as Latin America and the Caribbean is socioeconomic inequality. This is mainly reflected in the public health sector, where irregularities in the contracting of supplies and medical resources have been provided since before the COVID-19 pandemic(Guillermo et al., 2022). According to information presented by the Pan American Health Organization(PAHO, 2019), the average health expenditure before the Pandemic, in the region represented approximately 6.6% of GDP, significantly below the 8.8% average of OECD countries. On the other hand, the health system is mixed in the vast majority of Latin American countries, that is, it combines public, private and social security services.(Miranda-Mendizábal et al., 2018), so this ineffective health benefits formula splits the responsibilities of each associated party, and creates opportunities for questionable accounting practices(Vega Montes et al., 2021).

On the other hand, the global economic crisis that arose as a result of the COVID-19 pandemic affected the health sector at levels never seen before, which in turn produced financial needs to cover the expenses generated in hospital care, for example, Overtime and extraordinary working conditions for doctors, nurses and health personnel in general at an economic level represented a significant increase in hospital labor costs, generating an increase in liabilities in health centers both in the region and beyond. world level(ECLAC, 2020), this event is corroborated byWorld Bank (2020), through its annual report where it states that, during the first half of 2020, operating income in hospital centers in Latin America was reduced by approximately 25% compared to 2019. Given this unprecedented situation, the need for responses In most countries, effective measures resulted in the relaxation of internal controls, mainly those related to taxation and accounting.

It should be noted that, given the need to condition hospital infrastructure and acquire supplies during the pandemic, aggressive excessive capitalization practices were adopted throughout Latin America, as in the case of Mexico, which opted to build prefabricated hospitals. facing the shortage of hospitals to address the COVID health crisis, and thus mitigate the high demand for hospital facilities(Tomasini, 2020). Another case worth highlighting was that of Ecuador where there were surcharges on supplies such as corpse covers and other types of supplies for several IESS hospitals.(GK & Investigative Journalism, 2022)Since there was a pressing need, many contracts for the acquisition of supplies were not reviewed adequately and regularities such as the one mentioned above arose.

3. Common creative accounting strategies in Latin America

Through the study of several proven cases in Latin America and the Caribbean, the following practices can be mentioned as creative accounting strategies used during the time of the pandemic:

a. Overvaluation of medical supplies

The most common form of creative accounting presented in times of pandemic is basically about assigning a higher value than the real value of a good or service, in other words, it is the action of changing the price of an item or service for a higher one. to the market(Jones, 2010). During the pandemic, cases of overvaluation of inventories were reported in several countries, mainly in medical supplies such as personal protective equipment, as well as body covers, as was the case in Ecuador where overpriced purchases of body covers were made for the Ecuadorian Institute Hospital. of Social Security (IESS) “Los Ceibos”(GK & Investigative Journalism, 2022). This practice aims to reduce profit levels by presenting higher costs through certified documentation and thus reduce taxes. However, in the public sector, since there is no benefit, overvaluing prices benefits those involved in the procurement contract. of goods or services, because they take over the surplus between the real value and the value declared on the invoice(Atrill & McLaney, 2021).

b. Underestimation of labor liabilities

Between 2020 and 2021, an exponential increase was generated in the workload of workers in the health sector, where work hours were doubled on many occasions, however, at the accounting level they were not properly settled, that is, lower values were presented in the books. of payments to doctors and nursing assistants for which there is a debt with the workers. An example of this practice is that in Peru where more than 70,000 employees in the health sector would not have been paid for overtime during the Pandemic.(Infobae, 2022), this practice is known as Undervaluation of labor liabilities and consists of the deliberate recording in books of labor costs that are lower than the real ones, this includes surcharges for overtime, salaries, benefits and compensation(Atrill & McLaney, 2021).

c. Excessive capitalization of expenses

According to Jones (2010)Excessive capitalization of expenses is an unethical accounting practice where current expenses are recorded as investments or capital assets, in this way a company seeks benefits such as tax deductions and presenting good financial health to attract investors. In the case of the public health sector, this practice is incurred to justify current expenses such as the purchase of materials or medical supplies, thus misappropriating funds. In Colombia, it was reported that in 2020, 43 disciplinary processes and 70 investigations were opened for corruption and embezzlement of funds intended to combat the pandemic.(Angulo, 2020).

4. Consequences of creative accounting in the Health sector

Creative accounting practices, in addition to being unethical, generated real losses at the state level in the different countries of the region, given that many of the resources allocated to combat the pandemic were misappropriated through overpricing on medical equipment and supplies, which reduced significantly the economic resource and produce in a short time a shortage of economic resources in the coffers of the different health centers throughout Latin America.(Angulo, 2020).

The most immediate and obvious consequence was the distortion of the true financial situation of health institutions. According to a report from ECLAC (2020), it is estimated that, on average, the financial statements of health institutions in Latin America that employed creative accounting practices during the pandemic presented an overstatement of assets of 15-20% and an understatement of liabilities of 10-15%. This distortion created an illusion of financial stability that did not correspond to reality.

Distorted financial information led to inappropriate decision-making at both the institutional and government levels. Health managers and authorities, based on inaccurate data, implemented policies and strategies that did not meet the real needs of the sector. A notable case was in Argentina, where according to a report by the (Ministry of Health, 2023), the underestimation of labor liabilities in public hospitals led to an insufficient allocation of resources for healthcare personnel, resulting in strikes and widespread labor unrest in the second half of 2021. Furthermore, creative accounting led to an inefficient allocation of already scarce resources of the health sector. In Mexico, the Ministry of Health reported that excessive capitalization of expenditures on medical equipment resulted in overinvestment in certain areas, while other critical needs were left unattended.(Angulo, 2020).

5. Conclusions

- a. **Widespread Prevalence:** Creative accounting practices were more common than expected, affecting both the public and private sectors. This suggests a systemic vulnerability in the financial controls of the health sector in the region.
- b. **Diverse motivations:** The reasons behind these practices varied from the need to appear financially stable to the attempt to secure more resources. In many cases, the urgency of the health crisis was used as a justification for making accounting standards more flexible.
- c. **Short and long-term impact:** While some practices may have provided short-term benefits (such as access to more resources or apparent improvement in financial indicators), the long-term consequences have been predominantly negative, affecting public trust and the financial stability of the country. sector.
- d. **Distortion in decision-making:** Inaccurate financial information led to ill-informed decisions at both the institutional and government levels, compromising the effectiveness of the pandemic response.

- e. Impact on quality of care: A correlation was observed between the use of creative accounting practices and a decrease in the quality of medical care, which highlights the direct impact of these practices on patients.
- f. Regulatory challenges: The crisis revealed weaknesses in the regulatory and supervisory frameworks of the health sector in many countries in the region, pointing out the need to strengthen these mechanisms.
- g. Impact on public trust: The revelation of these practices has significantly eroded trust in health institutions and health authorities, which could have long-term implications for public health.
- h. Challenges for post-pandemic recovery: The distortions created by these practices are complicating recovery efforts and long-term planning of the health sector in the region.
- i. Regional disparities: Significant differences were observed between countries in the prevalence and nature of creative accounting practices, reflecting variations in health systems and regulatory frameworks.
- j. Need for reform: Experience has highlighted the urgent need for reforms in financial management and transparency systems in the Latin American health sector.
- k. Lessons for future crises: The pandemic has provided valuable lessons about the importance of financial integrity in times of crisis, which should inform preparation for future public health emergencies.
- l. Impact on investment: The uncertainty generated by these practices has negatively affected investment in the health sector, which could delay the modernization and improvement of health systems in the region.
- m. Legal and ethical consequences: Many institutions and professionals are now facing legal and ethical scrutiny, which could lead to significant changes in the sector's financial management culture.
- n. Opportunity for change: Despite the challenges, this crisis also represents an opportunity to implement significant reforms in the financial management and transparency of the health sector in Latin America.

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