ACCOUNTS MANIPULATION

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Abstract:
This article examines the literature on accounts manipulations (AM): earnings management including income smoothing and big bath accounting, and creative accounting. Accounts manipulations have become an issue of critical importance in recent years. During the last decade of 20-th century different hypothesis related to earnings management were investigated theoretically and empirically, but most of the related studies were applied to Anglo-Saxon countries and especially to US markets. In contrast, features of accounts manipulations in continental Europe and especially in Romania are relatively unknown. Main reason for this lack of research is the problem of data availability arising from the fact of non-transparent markets and unwillingness of companies to publicly announce full set of their financial reports.

Key words*: creative accounting, accounts manipulation, financial reports, true and fair view*

JEL classification: *M40*

1. Definition of Accounts Manipulation

Accounts manipulation have become an issue of critical importance in recent years. During the last decade of 20th century different hypothesis related to earnings management were investigated theoretically and empirically, but most of the related studies were applied to Anglo-Saxon countries and especially to US markets. In contrast, features of accounts manipulations in continental Europe are relatively unknown. Main reason for this lack of research is the problem of data availability arising from the fact of non-transparent markets and unwillingness of companies to publicly announce full set of their financial reports.

Despite the growing literature on the subject, still there is no common definition of the phenomenon. In most cases, accounts manipulations are defined as opportunistically used discretion over accounting numbers with intention to mislead users of the information. Schipper (1989:2) for example defines accounts manipulations as "a purposeful intervention in the external financial reporting, with the intent of obtaining some private gain (as opposed to say, merely facilitating the neutral operation of the process)." Healy and Wahlen (1999:386) consider it to occur "when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers."

The contents of accounts manipulations implicate the ways accounting is used to alter numbers reported in financial reports in order to modify users' perception of firm performance. The numbers can be manipulated:

- by use of "pure" accounting choices (misusing alternative accounting choices and estimates);
- by opportunistically classifying and disclosing items;

- or by structuring and timing real transaction in order to achieve reporting goals.

First and the last case can be defined as inter-period accounts manipulations, while the second case is intra-period accounts manipulations. Accounts manipulation is defined as the use of management's discretion to make accounting choises or to design transactions so as to affect the possibilities of wealth transfer between the company and society (political costs), funds providers (cost of capital) or managers(compensation plans). In the first two cases, the firm benefits from the wealth transfer, and in the third case the managers are acting against the firm. Figure 1 summarizes the principles of accounts manipulation.

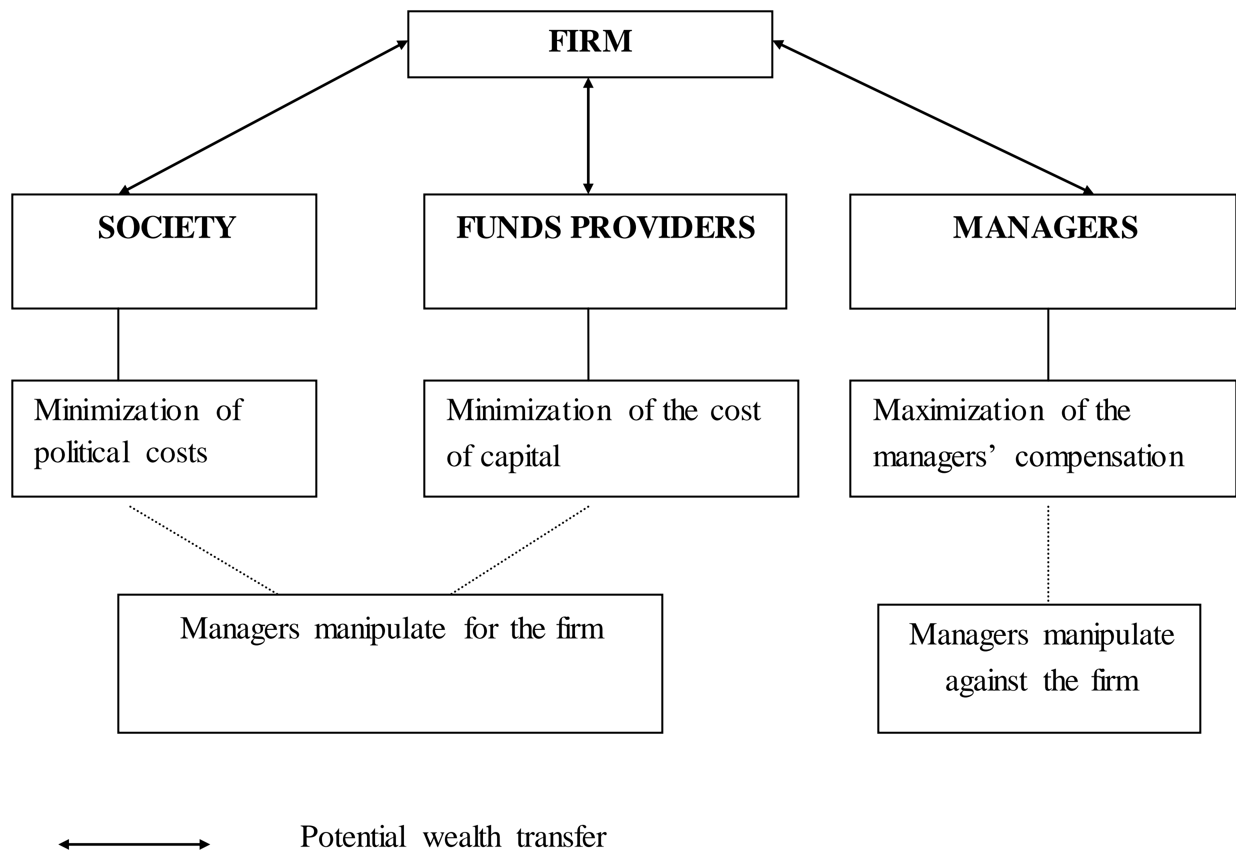

Figure 1. Principles of accounts manipulation

2. Actors and motivation

Manipulating accounts is a mangerial activity and the others players in the field influence managers'decisions to manipulate accounts.Therefore, if a theory of accounts manipulation can be constructed, it will not refer to the techniques used to manipulate, but rather to the needs, opportunities and relationships existing between the categories of market participants or stakeholders. As shown in Figure 2, there are many players in the game of manipulating accounts.

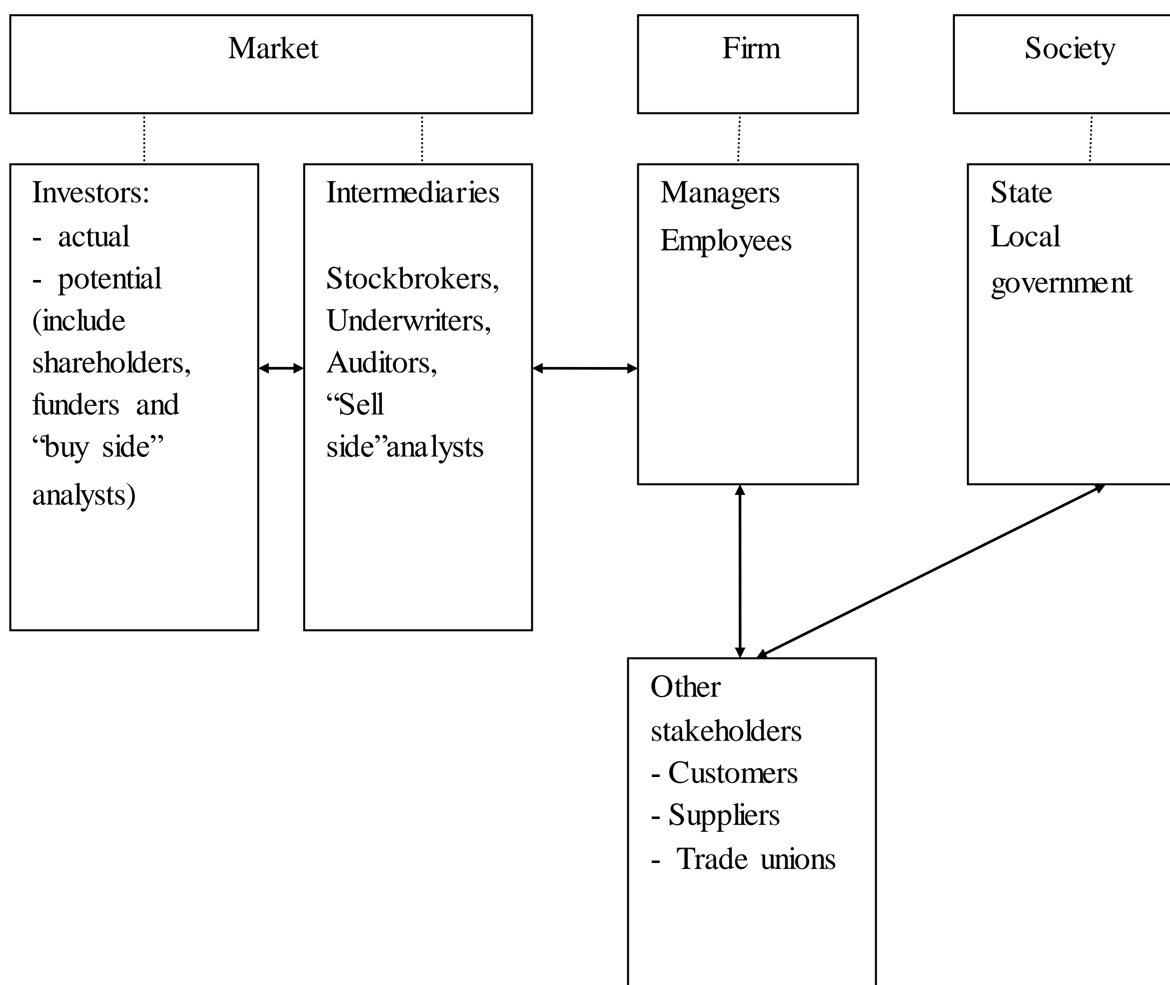

Figure 2. Players in the field of Accounts manipulation

By extention, investors can be divided into several sub-groups (existing and potential shareholders) having different interests and by consequence different reactions to accounts manipulation.

Analysts are also players in this field and can be split into two categories: "buy-side" and „sell-side" analysts. Financial analysts issue recommendations and forecasts. They normally try to forecast the reported numbers includding the effects of manipulation (Brettonand Taffler, 1995). Underwriters price issues that they sell. They make profit if a manipulation raises prices, and furthermore the issues may be easier to sell, which is another source of profit.

Auditors have two contradictory goals.First, they want to satisfy the client; second, they want to avoid excessive risk from third parties. The quality of auditors may also have an effect on the degree of earning management.

Managers either may or may not belive in market efficiency. If they do not, they may try to manipulate the numbers. Their aims would be to reduce the cost of capital, to satisfy the external demand of existing shareholders, to increase their own remuneration, to decrease the overall risk of the firm. The context of market inefficiency helps them, since the investors are easy to manipulate.

There are thus many forces that influence the accounts and, more particulary, the profit figure. From the interest of each group arises the motivation to manage accountings figures. Many authors have studied these motivations directly and indirectly. Several have been identified, ranging from the managers'incentives to manipulate earnings to the reason of other stakeholders. The most important work in

this area is the paper written by Watts and Zimmerman (1986), which propose a theory for accounting procedure choice containing some essential motivations (Table 1.)

Table 1. Potential gains in manipulating accounts

Players	Gains
Managers	• Reducing the cost of capital • Keeping their job • Managing their remuneration • Respect the debts convenants • Official examination • Minimization of income tax • Gain tax advantages • Stable dividents
Initial shareholders	• Increase their wealth
Existing controlling shareholders	• Increase the market value of their shares • Reducing the cost of capital • Reducing the volume of transations • Controlling employees claims
Existing non-controlling shareholders	• Increase the market value of their shares
Employees	• Keeping their jobs • Increase their remuneration
Suppliers	• Keeping their client
Clients	• Continuous servicrs • Warranty respected
State	• Tax to collect • Jobs for people
Bankers	• Repayment of the loan

3. Accounts manipulation between law and fraud

In most countries, the generally accepted accounting principles allow for a certain degree of interpretation. To be legal, interpretations may be in keeing with the spirit of the standard or, at the othe extreme, clearly stretch that spirit while remaining within the letter of law.

Fraud occures when somebody commits an illegal act. In terms of financial statements, for instance, fabricating false invoces to boost sales figures is fraud, while interpreting consigment sales as ordinary sales is an error.

The range of accounts manipulations is mostly discussed within the context of legal and illegal actions (i.e. financial statement fraud). Gulin (2002) points out that although label "manipulations" evokes negative connotations associated with illegal actions, not all manipulations are *a priori* illegal and negative. In most cases, manipulations are understood to be the legal end of a continuum, while financial stateare understood to be the legal end of a continuum, while financial statement fraud is at the illegal (see Dechow and Skinner: 2000).

In general, the accounts manipulations can be defined as the manipulation of accounting numbers that are not in accordance with the concept of "true and fair view". It is, as Jameson (1988) described, the process that operates within the letter both of the law and of accounting standards but it is quite clearly against the spirit of both. Although the distinction between accounts manipulations and financial statement fraud

is not always clear, to label accounts manipulations fraud, one need to establish the fact that the “financial number game” has fooled users of the statements and the “game” has to be defined as fraud by administrative, civil or criminal procedures (Mulford and Comiskey, 2002).

4. Conclusions

What causes managers to manipulate their financial statements? The answer has a critical importance to the efficient functioning of capital markets. For an investor it can lead to improved returns, for an auditor it can mean avoiding costly litigation, for an analyst it can mean avoiding a damaged reputation, and for a regulator it can lead to enhanced investor protection and fewer investment debacles.

But the most important question that still remains is „ How best can investors, auditors, financial analysts and regulators detect manipulations? We may believe that accounts manipulation is a sorry business. However, if we compare with all other activities in the world, we may wonder why accounts would not be manipulated.

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