

CREATIVE ACCOUNTING AND FISCAL FRAUD.

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Abstract:

This study suggests to highlight the fact that accounting information does not succeed reflecting the real image of an entity only partially due to the manipulation of accounting data by practicing creative accounting by accountants, managers, under the careful management of auditors which certify the fact that the financial situations reflect the reality. Creative accounting has as a common goal creating a distorted image of the entity, more prosperous, misleading the information users through financial components. Handling techniques are offered by the treatments and the accounting politics recommended by the national accounting standards and International Accounting standards.

Key words: *creative accounting, faithful image, fiscal fraud*

The accounting fundamental objective is providing information that offer a faithful and just image of the financing position and of the financing performance of each entity as well as the their time modifications (1)

1. Regarding the concept of faithful image

For the accounting information to be useful for the internal and external users it must fulfil four quality characteristics: audibility, pertinence, credibility and comparability (2)

The concept of faithful image in accounting is approached from two points of view:

a). the Anglo-Saxon one where there is a release of the fiscal accounting, and the fiscal result is determined extra-accounting, the accounting must offer a faithful image of the economic reality that can be reliable, verified and neutral. In order to be reliable the information must faithfully reflect the transactions and events it proposes to represent or it should represent (3)

Financial Accounting Standards Commission (FASB) offers priority to the economic aspect of the accounting information that is proposed and broadcast only if it is useful for taking a decision, the utility being the fundamental characteristic of the accounting information (4)

b). the continental one (France, Germany) where the financial accounting serves some fiscal purposes, that is for determining the fiscal result. In this situation, the faithful image appears as an objective of the annual accounts and wants to apply the postulates and the principles of fundamental accounting.

The faithful image is obtained when the accounting principles are convergent or when their divergences are solved in a rational way. The faithfulness is not only the reality of description but also the non-deceiving presentation of this reality.(5). This supposes that the accounting information producer has the capacity of appreciate the quality of the accounting information, not subjectively depending on his needs, but taking into consideration its external recipients (6).

The unfaithful image of reality refers to the inconsistency of the image represented by the accounting information, it is based on non-authentic documents and it is usually offered to the external users.

Therefore we may appreciate the faithful image as being criteria of the accounting performance, of complex nature that is based on ethical and moral concepts: truth, sincerity, frequency, neutrality and permanent continuity.

2 Creative accounting

Realizing the faithful image is conditioned by keeping with good faith and professional competence the national accounting principles or conventions, or the communitarian or international ones. Despite all the norms organisms, the increase of the financial situations, the accounting information does not succeed to give a faithful image of an entity but partially, situation proven by the numerous financial scandals, as a result of manipulating the accounting data by practicing “creative accounting” by accountants and managers, under the supervision of auditors that have certified that the financial situations reflect the reality.

The concept of creative accounting initially used in the Anglo-Saxon environment represent the accounting practice that have as a result the misleading of the information users by presenting information that the information producers would like to have.

Although the creative accounting (the imaginative accounting, the intentional or accounting engineering) has been an interest for many researchers, there is no mutual agreement regarding its definition. A more complex vision on the creative accounting belongs to K. Naser who considers that because:

a /the process to manipulate the accounting figures due to a breach of the rules and regulations. It is possible that taking advantage of the allowed flexibility to choose that measuring and information practice that allow the transformation of the synthesis documents from what they should be into something that managers want.

b / the process through which the transactions are structured in such a way to allow the accounting result wanted (7).

All the approach have a connexion, to comply with the legislation, but the creative accounting has as a commune effect the creation of a distorted image of the entity, more prosperous or misleading the information users by the means of the financial situations components. The creative accounting exploits the possibilities, the inconsistencies, the incompleteness or the “doors” left open intentionally or by mistake by the law creator. It is “creative” especially at the analytical accounting level (cost accounting level) because at the level of financial accounting, the international norms and standards limit the creating possibilities.

It is to be notices that, mainly, the creative accounting presents two major aspects:

a). using the imagination of the accounting pros to apply the judicial, economical and financial innovations for which there are no accounting solutions expressed by norms or unanimously accepted, at that specific moment;

b) the innovations are initiated depending on their incidence over the financing situations, by manipulating the accounting truth if their certification by the auditors is possible.

In most of the situations, the manipulation techniques of some entity’s performance come from the possibilities offered by applying the treatments sand the accounting policies recommended by the national accounting norms (8) and the International Accounting Standards. These bring into discussion the use of the professional judgement at the analysis and the interpretation of an event or economic elements, of the accounting options at the level of individual accounts that allows the modelling of the result and the financial situations content. The presence of options into the accounting regarding the allowed accounting policies, referring to the basic and alternative treatments, gives the entity’s manager the possibility to be tempted, depending on the interests wanted, to shape the financial result presented in the financial situations, by significantly increasing or diminishing it to the real one. At the same time, some elements of the financial situations cannot be exactly valued and must be estimated, this implies value and professional judgements.

In Romania, as in other continental countries, the accounting system is not independent to the fiscal one, meaning that the fiscal result is determined by the following relation:

Taxable profit=cumulated accounting profit + non deductible expenses – non-taxable income

We want to refer to some of the creative accounting practices that want to shape the accounting result and the procedures with an impact on the annual balance sheet.

A. *Practices regarding the shaping of the accounting result* refer to the intangible assets, stocks, provisions and adjustments, etc

a) In the field of intangible assets the accounting policies refer to the assets depreciation, the depreciation of the intangible assets and the valuation of the intangible assets and the financial titles. Thus in the field of assets depreciation, IAS 36, and the Romanian regulations, it is requested that for each date of elaborating the accounting balance sheet, to mention if an asset has suffered depreciations. It must be valued at the lowest given value. A subjective manager can appreciate that there are no depreciation indicators for the assets, and therefore the exploitation expenses are not increased and the profit is not affected. If it is considered that the recoverable value is lower to the accounting net value, the asset is considered depreciated for the difference, the result (profit) is diminished with the expenses for the depreciation adjustments.

A special problematic of the creative accounting refers to the intangible assets depreciation. The choice between one and the other depreciation methods – linear, digressive or accelerated – and of the life duration of the assets determine different depreciation expenses with a different impact on the exploitation result. In the first year of activity the linear depreciation being the smallest one creates the image of a performance entity. In the following year the linear depreciation is the same with the previous year. The digressive depreciation method shows a situation that presents an increase of the entity's performance because the depreciation value is diminished and a constant depreciation rate is applied to a digressive value. The accelerated method is less used, because the depreciation must be correlated to the way of use of the intangible asset, and the situation when such an asset is consumed in a rate of 50% in the first year of activity are rare. In the field of assets there are also some other possibilities of shaping the accounting result that is the subjective valuation of intangible assets and of the financial titles and the leaseback operations that perform artificial transactions to manipulate the balance sheet values or to adjust the result by selling an asset and by taking it at the same time by lease for the remaining period of its life. The selling price can be higher or lower than the actual value of the asset, because the difference can be compensated by higher or lower rents.

b). In the field of stocks there are several possibilities of sub-valuation or over – valuation of the stocks to influence the financial result of the entity. First of all by including dead or morally used stocks into the total stocks:

- if these are not taken out the expenses are affected, and the result is diminished;
- if it is considered that they can be capitalized, the income increase and so does the financial result.

Secondly, the valuation of stocks in the inflationist periods, when there are taken out of the accounts by using the FIFO or the LIFO method has an impact on the profit and loss account::

- the valuation by the FIFO method, at the lowest prices and the final stocks at the highest prices contributes at the increase of the exploitation result and implicitly of the tax on profit;

- the LIFO method the decrease of stocks is valued at the highest prices, and the final stocks at the lowest prices, this determines a diminishing of the exploitation result and of the tax on profit.

- during the price reduction period the situation is inverted.

Third of all, the treatment of the purchase expenses for the onerous goods. The inclusion or the exclusion from the purchase expenses of the import or export costs except those that can be deduct from the fiscal authorities, transport expenses, handling, and etc lead to the increase or decrease of the financial result.

Fourth of all it is about the treatment of the finite goods stocks. The increase or diminishing of the finite goods stock determines the increase or diminishing of the income, respectively the increase or diminishing of the financial result of the entity.

c) The financial result can be modified also by the means of provisions and adjustments for the value depreciation of assets. Thus, the over estimation of their constitution based on the expenses in the profit years lead to the diminishing of the result and the turn to income in the following year or years contributes to the increase of the result, both situations influencing the tax on profit

B. The procedures with an impact on the balance sheet refer mainly to the revaluation of tangible assets that influence the increase of the asset value, the increase of the depreciation expenses as well as the increase of the total of own capitals by augmentation of the revaluation reserves.

3. Creative accounting and fiscal fraud

In most of the situations of creative accounting, the choice and application of the accounting policies fits into the field of flexibility of the national norms and standards in force. The way the accounting policies are used representing the own principles, conventions, rules and procedures for the situations stipulated by the law, must be approved by the entity's administrator (9). The way of applying policies is based on the professional judgement of the accounting pros and generates the creative accounting.

The creative accounting does not intermingle with the accounting mechanism of the fiscal evasion and fraud. This represents an assembly of illegal practices used by the tax payers in order to avoid the tax payment, practices incriminated by the law. It refers to financial and accounting legislation infringement during the process or registration of the financial and accounting information. The fiscal evasion does not intermingle with the fiscal avoidance. The legal avoidance of tax payment or the fiscal avoidance expresses the tax payer action to avoid the legislation by getting the best out of a combination unforeseen by the law giver and thus tolerated by omission (10).

The accounting mechanism of the fiscal evasion refers to the infringement of the law ad not to the "creative" aspect of the accounting and creates an unfaithful financial image of the entity's activity. This image is addressed to the external users, especially state fiscal institutions and usually it differs from the image given to that specific entity's managers. The purpose of modifying the financial image is the reduction of the taxable base and the diminishing of the state rights to take a part of the tax payers fiscal income. This means that the accounting mechanism of the fiscal evasion can operate on the final result by reducing the receipts or by diminishing the disbursements.

The fiscal evasion by diminishing the receipts can be considered as contraction fiscal evasion, and the one generated by the increase of expenses is an expansion fiscal evasion (10). The two forms present essential differences regarding the ways and methods used in the accounting mechanism of the fiscal evasion.

The two procedures must not happen simultaneously. It is sufficient to use only one of them. The choice is base especially on the valuation that the evasion authors give regarding the institutional capacity of the state organisms from the fiscal field to detect fraud and they will use that method they consider less transparent for the fiscal inspection. The accounting information does not play an active role in identifying the fiscal evasion. It has a passive role, but it contains relevant information for the evasion field. The fiscal evasion's opacity at the accounting information level is the one that generates both the success in accomplishing the fiscal evasion and the failure of the

fiscal inspection in identifying it. The accounting information represents the type of information that may contain signs or indicators regarding the producing of the fiscal evasion. Its valuation depends on the ability, competence and good-faith of the personnel that performs the fiscal inspection. At the same time the accounting system of the entity must be coherent, it must have a documented base so that the systematic verification of complying with the accounting principles, policies and the normative and logic correlations between the positions and the flux indicators of the entity can provide those visible signs necessary and sufficient to declare the production of a fiscal evasion phenomenon.

The fiscal evasion mechanisms consist out of many instruments. In the case of fiscal evasion generated by the increase of the expenses, the expansion fiscal evasion, *it includes overestimation techniques of the deductible expenses, such as* (11):

- Overestimation of the depreciation rates;
- Infringement of the fiscal deductibility regulations for the transport, protocol, advertising and sponsorship expenses;
- Infringement of the fiscal deductibility regulations of the provisions (the overestimation of the risk provisions, the deductibility of debts provisions without a court decision, etc)
- Registration of imaginary services, or some services with exaggerated values, especially from external suppliers (consultancy, management, licence acquisitions, trade marks, informatics programmes).
- Identifying the accounting losses with the fiscal losses.

The techniques of underestimation of the income, a contraction fiscal evasion, consist out of the underestimation of the taxable values or other ways of not paying the due taxes. These are many and have nothing to do with the creative accounting; they can take different forms such as:

- unreal depreciations, overestimated depreciations / other assets values or different numbers
- fake payment documents, selling goods without an invoice, invoices with no real selling
- depreciation of the turn over by unreal expenses;

The contraction fiscal evasion happens also when wrongly determining the indirect taxation base by different procedures such as:

- wrongly applying the deduction regime:
- not including some operations into the VAT field:
- not registering as a VAT payer when the limit established by the law is reached, etc.
- VAT corresponding to the income obtained and not registered from selling some goods;

-the over estimation of expenses by: registration of some stock at unreal prices, higher than the market ones, by invoices from fictitious companies, using the company's goods for own purposes and than register the corresponding expenses, fake deduction report for business travels, registration of some fake commercial penalties.

It is not necessary that the two procedures produce simultaneously. Their dynamic has certain limits. First of all it is about the general trend of the entity's activity, meaning that no visible discrepancies between the indicators can appear that express the current entity's activity and the results indicators. Secondly it is about a functional bond between the expenses dynamic and the expenses: the expenses cannot grow over a certain limit that expresses the expenses contribution to the formation of income

The following question can be asked if in the evasion accounting mechanisms there must be a limit an optimal limit of the basic reduction of taxation taking into consideration at the same time the contraction and the expansion evasion. Choosing it is

based on the valuation the fiscal evasion's authors make regarding the institutional capacity of the fiscal inspection to depict fraud choosing a less transparent method.

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