ACCOUNTING PRACTICES UNDER THE INFLUENCE OF CREATIVITY

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Abstract:
Creative accounting has emerged and developed thanks to the managers' wish to present a certain financial image of an entity in terms of the financial statements. Even if creative accounting distorts the financial image of an entity, it differs fundamentally from fraud in that it complies with the regulations and rules on accounting. Basically, creative accounting complies with the "letter" of the law, but not with its "spirit". For this reason, accounting setters and experts have the difficult task of finding solutions in terms of limiting accounting creativity.

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1. Introduction

An entity's financial image is presented by the financial statements that reflect the entity's financial position and performance, as well as the changes in the financial position and in the financial performance.

An entity's financial image is nevertheless presented differently depending on the interest or purpose of the management. Thus, depending on the purpose set, they make up the entity's accounting policy by choosing the accounting options allowed by rules according to the intended purpose. Basically we talk about creativity in terms of presenting the information in the financial statements' structures.

2. The concept of creative accounting

Despite the efforts of harmonising the accounting standards internationally, the accounting information fulfils only partially its incumbent duties. The most striking fact in supporting this finding is given by the numerous financial scandals.

They are based either on discovering certain forgeries or on the use of certain (allowed) accounting practices to conceal the real situation or untrue reports of auditors. The use of (allowed) accounting practices to polish up reality is known as accounting engineering or creative accounting.

Trotman defines creative accounting as a communication technique aimed at improving the information provided to investors [M. Trotman, 1993].

Stolowy reduces the significance of the concept of creative accounting, stating that: fraud has nothing creative, the practice of accounting options has existed for a long time and it is not creative accounting, the inherent subjectivity of the assessment is unavoidable and there have always been only a few financial mechanisms that generate genuine creative accounting. The distinctiveness of creative accounting, the French author concludes, depends on the accounting imagination put into practice in order to interpret the legal, economic and financial innovations for which, on the date of their launching, there are no normalised accounting solutions, as well as the fact that the assemblies resulting from this financial engineering are initiated depending on their incidence on the balance sheet and on the result of the enterprise [H. Stolowy, 1994].

Nevertheless, the most substantial definition belongs to Naser. According to it, creative accounting is: 1) the process by which, given the existence of certain gaps in the rules, the accounting figures are manipulated and, taking advantage of the flexibility, the measurement and disclosure practices that are chosen are those that allow the transformation of the summary documents from what they should be into what the managers want, 2) the process by which the transactions are structured in such a way as to allow the "production" of the desired accounting result [K. Naser, 1993].

The concept of creative accounting can be defined as the process by which expert accountants use their knowledge to manipulate the figures included in the annual financial statements, taking advantage of the possibility of interpreting the rules and of the existence of numerous options in solving various accounting problems [F.C. Dima, vol. XVIII - supplement, p. 157].

Regardless of how it is defined or its name, creative accounting or accounting engineering refers to the process by which the economic transactions performed by an entity are structured and processed by means of accounting policies, in such a manner so as to obtain the desired accounting result. The fact that the accounting policies are based on legal rules and regulations in force distinguishes creative accounting from fraud or crime. However, creative accounting received the reproach that, though it strictly complies with the letter of the regulations and legal norms, it does not comply with their spirit.

3. The motivational complex of using and developing creative accounting techniques

The financial statements reflect the entity's financial image and creative accounting is the tool by which it is achieved.

The use and development of creative accounting techniques is stimulated by a number of factors that can be presented concisely as follows:

- permissiveness of accounting rules and regulations: it takes into consideration the fact that it is possible to choose from several options or accounting treatments related to the assessment of the elements in the financial structures, as well as the fact that for a number of elements there is the opportunity of making estimates or forecasts;
- the managers' incompetence: it takes into consideration the fact that they hide their lack of performance by: fine-tune
  - polishing up the financial statements using creative accounting;
  - choosing the moment for making a transaction to give a certain image in the accounts (for example the sale of a fixed asset with a market value greater than the accounting value in the year in which the increase of the result is wanted);
  - the use of "artificial" transactions aimed at "smoothing" the result or at manipulating the values in the financial statements (for example the lease-back).
- the uncertainty and risk reigning in the economic environment: it takes into consideration the financial crisis we are going through and which generates an increased volatility of the market, in general, and of the capital market, in particular;
- the financial-accounting information users' behaviour: it takes into consideration the fact that they provide too much attention to the accounting result, which stimulates the use of creative accounting techniques;

- taxation: it takes into consideration the fact that the high tax burden represents an incentive for the use and development of creative accounting techniques.

4. Creative accounting practices

The opportunities to practice creative accounting are given by the existence of accounting options regarding the accounting and assessment methods related to tangible and intangible assets, inventories and works in progress, construction contracts, etc. As a result, the entities' management will adopt a certain type of policy depending on the interest it has either to increase or to decrease the result.

Creative accounting practices applied by an entity's management team, as well as their impact on the result can be presented concisely as follows:

Accounting practice	The management aims to increase the result	The management aims to reduce the result
The treatment related to the acquisition cost	Including an amount of expenses as high as possible in the assets' acquisition cost.	Including an amount of expenses as high as possible related to the acquisition cost in the current expenditure of accounting period.
The treatment on the production cost	Including an amount of expenses as high as possible in the production cost.	Including an amount of expenses as high as possible related to the production cost in the current expenditure of accounting period.
The treatment related to the assessment of fungible stocks out	• if we take into account the provisions of IAS 2 "Inventories" in terms of price increases, the FIFO method will be used and in terms of price decreases, the CMP method will be used; • if we take into account the national provisions of OMFP 3055/2009 on the approval of "The Accounting Regulations Compliant with the European Directives" in terms of price increase, the FIFO method will be used, and in terms of price decreases, the LIFO method will be used.	• if we take into account the provisions of IAS 2 "Inventories" in terms of price increases, the CMP method will be used, and in terms of price decreases, the FIFO method will be used; • if we take into account the national provisions of OMFP 3055/2009 on the approval of "The Accounting Regulations compliant with the European Directives" in terms of price increases, the LIFO method will be used, and in terms of price decreases, the FIFO method will be used.
The treatment related to expenses on interests	Capitalisation of interest expenses.	Acknowledgment of interest expenses in the current expenses of the accounting period.
The treatment related to the depreciation of fixed assets	The use of the straight-line depreciation method.	The use of the accelerated depreciation method.
The treatment related to the re-evaluation of tangible assets	There is no performance of the re-evaluation of the depreciable assets or re-evaluation of the non-depreciable assets.	Re-evaluation of depreciable assets.
The treatment related to the expenditure subsequent to starting using tangible assets	Capitalisation of expenditure subsequent to starting using tangible assets.	Acknowledgement of the expenditure subsequent to starting using tangible assets directly in the income statement as current expenditure
The treatment related to the method of accounting for construction contracts	The promotion percentage method.	The works completion method.

There are other practices that can be added to these creative accounting practices that are not necessarily related to accounting, but have the effect of polishing up the financial statements, such as for example:

- increasing the stock of finished goods, if the aim is to increase the result, or to reduce it if the aim is to decrease the result;
- choosing the moment for making a transaction, such as for example the sale of an asset with a market value greater than the accounting value, which leads to the increase of the result;
- in order to smooth the result or to manipulate the balance sheet values, "artificial" transactions are used, such as the lease-back, etc.

To substantiate the above we shall analyse some creative accounting practices relating to stocks and fixed assets.

Creative accounting practices related to inventory are based on accounting treatments regarding the stock assessment recommended by IAS 2 "Inventories" [IFRS, 2011, IAS 2], which are valued by professional accountants' creativity. For example, the result desired by the entity's management, the acquisition costs of inventories will be directed to be included or not in the purchase cost.

We consider in this regard that an entity acquires goods in the following conditions: purchase cost of goods 50,000 mu, transport costs 1,500 mu, handling expenses 500 mu, revenues from the sale of goods 70,000 mu.

According to the manager's decision to include or not the transport costs in the profit and loss account, the results will be presented as follows:

Extract from the profit and loss account

mu

Elements	Transport costs included in the cost of goods acquisition	Transport costs excluded from the cost of goods acquisition
Revenues from the sale of goods	70,000	70,000
Cost of goods sold	52,000	50,500
- purchase cost	50,000	50,000
- transport expenses	1,500	--------
- handling expenses	500	500
Accounting result	18,000	19,500

We note that where transport costs are included in the acquisition cost, there is a lower result and vice versa. Thus, managers can increase or decrease the result, in accordance with the purpose.

Another possibility to influence the result using the policies related to stocks is considering the possibility to include the borrowing costs in the cost of inventories under IAS 23 "Borrowing Costs"[IFRS, 2011, IAS 23].

For example we start from the fact that an entity has acquired during the year N finished products at the production cost of 5,000 mu, it recorded expenses of 3,000 mu with the raw materials, expenses with salary and social contributions of 2,500 mu, other operating expenses in the amount of 500 mu and expenses with the interest of bank loans in the amount of 600 mu, and the turnover recorded was 15,000 mu. The result will be different depending on the entity's management decision to capitalize the interest expense or not.

The application of the mentioned accounting treatment has the following impact on the profit and loss account:

Extract from the profit and loss account

mu

Elements	Interest is capitalized	Interest is not capitalized
Turnover	15,000	15,000
Variation of stocks	5,600	5,000
Expenses with raw materials	3,000	3,000
Salary and social expenses	2,500	2,500
Other operating expenses	500	500
Operating result	14,600	14,000
Expenses regarding the interest	---------	600
Accounting result	14,600	13,400

Including the interest expense in the cost of inventories distorts the real image of the entity, determining an increase of the result.

Creative accounting practices related to tangible assets are based on the accounting policies and treatments related to tangible assets and stipulated in IAS 16 "Tangible assets"[IFRS, 2011, IAS 16].

The standard provides that in case of expenses after commissioning an item of land and tangible nature that has already been recognized, they must be added to the accounting value of asset only when it is estimated that the entity will obtain supplementary future economic benefits compared to the performance originally expected as appropriate.

To exemplify we consider that an entity has initially renovated at the beginning of exercise N an industrial hall. The industrial hall was purchased 28 years ago at an input value of 3,000,000 mu, and its useful life is 30 years. The renovation expenses were 140,000 mu (28 year). The entity's management believes that the deterioration degree of the industrial hall is high, and its restoration is necessary to ensure a continuous functionality. The proposed solution is the non-capitalization of the renovation costs. If the entity's managers take into consideration the purchase of new industrial hall and the sale of the existing one, they would choose the capitalization of the renovation costs. Having the turnover of 1,000,000 mu, costs with the raw materials of 550,000 mu, salary and social costs of 120,000 mu and other operating expenses of 30,000 mu, the income statement looks like this:

Extract from the profit and loss account

mu

Elements	N		N+1		N+1	
	Renovation expenses		Renovation expenses		Renovation expenses	
	It is capitalized	It is not capitalized	It is capitalized	It is not capitalized	It is capitalized	It is not capitalized
Turnover	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Renovation expenses	----------	140,000	----------	----------	----------	----------
Depreciation expenses	100,000	100,000	100,000	100,000	100,000	100,000
Expenses with raw materials	550,000	550,000	550,000	550,000	550,000	550,000
Salary and social expenses	120,000	120,000	120,000	120,000	120,000	120,000
Other operating expenses	30,000	30,000	30,000	30,000	30,000	30,000
Impact on the result sheet	0	140,000	70,000	0	70,000	0
Accounting result	200,000	60,000	130,000	200,000	130,000	200,000

Capitalisation of the renovation costs has no effect on the income statement in the year in which they were made and it influences the years N +1 and N +2 alike. In case they are not capitalised, they have a major impact on the income statement of the year N and they have no influence on the future years N +1 and N +2.

Related to depreciation, the regular method chosen for depreciation is the one which reflects the rate at which the future economic benefits are consumed due to the use of the respective asset. The entities have the possibility to choose between the different depreciation methods resulting in the many cases, to different results.

Regarding the revaluation of tangible assets we can say that many distressed entities make use of this accounting engineering construction, as an ultimate chance to improve the performance reflected in the statement of changes in equity.

5. Ways of limiting creative accounting

The creative accounting techniques are various and they get diversified together with the occurrence of new stimuli. As a result, the wish of accounting setters to limit creative accounting must consider the circumstances that allow its expression.

Some of the possible steps of diminishing the creative accounting techniques may be summarised as follows:

- a first step to limit creative accounting should aim at reducing the allowed number of accounting processing or to accurately determine the circumstances under which each option should be applied;
- adoption and implementation in as many countries as possible of the accounting rules issued by the IASB so as to achieve an international accounting harmonisation;
- diverting the accounting information users' attention from the result towards the other information resulting from the financial statements;
- another possibility would be to better regulate auditing and to harmonise auditing standards internationally.

6. Conclusions

In conclusion, we can say that accounting engineering involves the use of procedures which are based on the choices allowed by the accounting regulations and rules to optimise the entity's image through the financial statements.

Accounting creativity is stimulated by a number of factors that cannot ever be fully removed, which makes the task of accounting setters and experts of limiting the creative accounting practices to be a very difficult one.

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