

Specific Procedures and Techniques of the Creative Accounting Concerning Tangible Assets Reevaluation

Andreea Elena Dreghiciu

„1 December 1918” University, Alba Iulia, Romania

deea_dreghi@yahoo.com

Alina Puțan

„1 December 1918” University, Alba Iulia, Romania

putan.alina@yahoo.com

Abstract

For profoundly understanding the reality which is transposed in the financial situations of an entity, it is necessary that one knows the diverse procedures and techniques of creative accounting, with the purpose of subsequent identification of the cases in which it has been resorted to the “embellishing” of these financial situations, and in the same time for knowing the reasons and also the consequences of these techniques and procedures.

By creative accounting both the result and the entity’s audit may be influenced. Among the different procedures which influence the audit, the ones concerning tangible assets reevaluation are clearly distinguished, these usually being practiced by entities which are in difficulty, having the purpose of rising its own capital (by forthcoming the reevaluation reserves) and thus they may artificially increase their indebtedness capacity.

Key words: creative accounting, tangible assets, reevaluation, reevaluation reserves

J.E.L Classification: M40, M41

1. Introduction

Although the financial information is made in a legal frame which precisely establishes the rules of its presentation, usually it is ascertained that many entities practice a result correction and a result adjustment, which is legitimate and legally. These entities take advantage of the juridical and financial laws’ versatility, from where the concept of creative accounting is derived. (Cernusca, 2004, p.385). Thus, the usage of creative accounting may be considered a result of flexibility allowed by the actual accounting regulations, which, when applied in good faith, leads to a trustworthy image concerning both of the financial position and also of the performance of the economical entity.

In order to present actual information, which are necessary to all categories of users, the entities need to apply the evaluation instrument and respectively the reevaluation one. This thing is due to the fact that there are a series of elements which action leads to the appearance of certain distortions. The next factors may be included: free prices, exchange ratio of national currency, internal management of economical agents. (Păvăloaia et. Al, 2006, p.7)

Creative accounting holds diverse procedures with great impact upon balance, which use as a mechanism exactly the tangible assets reevaluation.

Conceived and structured on a complex matter, the given paper is considering the presentation of certain elements from creative accounting which refer to tangible assets reevaluation, as well as a study case which practically reflects the inference of different creative accounting procedures and techniques which refer to tangible assets reevaluation of the elements’ accounting enlistments.

2. Methodology

Any research which is intended to be a scientific one should have a purpose. The purpose of this research is to present certain theoretical and practical aspects concerning the importance of different creative accounting procedures and techniques, on tangible assets reevaluation.

The methodology I have used is based on theoretical research concerning concepts and regulations in the domain, accompanied by empirical research. For compassing this paper I appealed to studying the International Standards of Evaluation, to papers in the field of creative and financial accounting written by committed authors, to analyzing the regulations in the domain, thus being a qualitative exploratory research, and also, I have appealed to practical aspects which are specific to different procedures of creative accounting concerning tangible assets reevaluation, thus being a quantitative descriptive paper.

3. Tangible assets reevaluation

Current assets are assets items, detained for more than a year, being generators of future economical benefits for the entity. (Matiş et al., 2010, p.144)

Tangible assets are those tangible elements detained for being used in manufacturing or in providing services, for being rented to a third party or for being used in managerial purposes, and which are envisioned to be used during different periods of time. (IAS 16, 2015, paragraph 6)

Tangible assets gradually lose a part of their value usage as a consequence of their utilization, as a consequence of natural agents' action and of technical progress. This physical and value depreciation is named attrition. (Pântea et al., 2013, p.57) Tangible assets attrition is adjusted and classified according to two main aspects:

- permanent, definitive and irreversible adjustment, also known as amortization
- reversible, temporary adjustment, also known as adjustment for depreciation (Matiş et al., 2010, p.146)

For tangible assets, accounting value at the balance date is determined based on the evaluation rules subsequent to the initial recognition, through reevaluation. Reevaluation of assets is the economical operation after which the accounting value of the assets is correlated with the actual value or with the inventory value, ensuring the relevant data enlistment in the annual financial reports, the calculation of economical-financial indicators in the most exact way, and therefore, a more exact note of the users of accounting information. In order to do that a great importance is the correct establishment of the reevaluated value. (Matiş et al., 2010. P.162)

The operations concerning the tangible assets reevaluation are recorded in accounting using mainly two treatments:

- the gross value of tangible assets and the cumulated amortization are simultaneously reevaluated;
- cumulated amortization and the depreciation adjustment are excluded from accounting value (Pântea et al., 2013, p.162).

4. Considerations concerning creative accounting

Creative accounting is a communication technique which regards the amelioration of information given to the investors. Taking advantage of the normal limits of accounting we appraise that through creative accounting the image of financial position and of the company's performances is embellished, but we consider this kind of practice as being the borderline of legality. (Trotman, 1993, p.83)

In another point of view, creative accounting could be understood as the process by which management uses certain deficiencies or ambiguities in the wording of accounting rules in order to submit the financial performance of a specific image. (Shah, 1988 p.83-104)

From another point of view, creative accounting may be defined as an assembly of procedures, which targets either modifying the result's level, having the purpose to depreciate or to maximize it, or presenting the financial reports in a certain way, without them being mutually excluded.

Accounting options always were at the accountant's disposal and these do not involve creativity in a strictly negative meaning of the word. (Stolowy, 2000, p.157-178)

Starting from the fact that the entities know the indicators followed by different users of accounting information, these are tempted to manipulate the numbers using diverse practices with effects upon the results or upon the different balance sheet items. As a result, a classification of these specific techniques and procedures used in creative accounting, may be made as follows:

- result account and accounting policy: modification of current results and of net result (amortization, provisioning, stocks, costs' display), modifying the current result without influencing the net result, modifying the net result without influencing the current result (grants for investments), taxation and accounting policy (costs enabling)

- result account and management decisions: current result amelioration (manufacturing amelioration, loss attenuation or transfer), amelioration of net result (lease – back)

- techniques of balance amelioration: own equity / funds (assets' reevaluation, financial montage), permanent loans (leasing), the need of working capital and treasury (discounting commerce effects). (Cernusca, 2004, p.403 – 404)

Among the creative accounting's procedures and techniques, certain aspects concerning tangible assets reevaluation, will be presented for exemplification.

Reevaluation solution may cause free way towards manipulations. The choice of turning to a reevaluation of tangible assets has impact upon the increase of the asset's value (and implicitly costs of amortization will increase too) and / or an increase of personal equity by respecting the limits of fiscal protocol. The entities being in difficulties may turn on to reevaluation as a subterfuge, in order to increase personal equity, with consequences on debt capacity. (Cernusca, 2004, p.429)

5. Study case concerning creative accounting techniques and procedures referring to tangible assets reevaluation

S.C. EXAMPLE S.A. has decided to reevaluate the immobilization in order to make annual financial reports. Following this procedure, the next the next were established:

- an installation acquired with the price of 170.600 RON, normal 10 years lifetime, amortized in linear mode, reevaluated at the end of the second year, with a real 197.200 RON value established by an authorized assessor

- a smoke chamber with a 185.238 RON input value, normal 20 years service life, linear mode amortization, reevaluated at the end of the fourth year having a 203.762 RON value.

Further, the disposal of the appliance will be presented in the year following the reevaluation, as well as the implications of creative accounting, but also some aspects concerning the consequences that amortization costs have on the result, in the case when the smoke chamber is reevaluated.

Case 1: Selling the installation at 188.000 RON at the end of the third year

Table no.1: Presenting technical installation

Nr. Crt.	Fixed asset name	Input value	Normal lifespan	Amortized duration	Amortized value	Net value (unamortized)	Fair value
1.	Technical installation	170.600	10	2	34.120	136.480	197.200

Source: own creation

Registering reevaluation operation in accounting:

%	=	105 „Reevaluation reserves”	<u>60.720</u>
2131, „Technological equipments (machineries, facilities and work installations)”			26.600
2813, „Installations and transport means amortization”			34.120

The installation will be registered in accounting at its real 197200 value.

Case 1. 1: Disposing the installation when this would not have been reevaluated

1. Booking the costs cumulated by amortization, after three years

6811,, Operating charges concerning depreciation of fixed assets” = 2813,,Installation and means of transport amortization” 51.180

2. Installation sale

461,, Diverse debtors” = 7583,, Incomes from assets’ sale and other equity operations” 188.000

3. Management discharging

% = 2131,,Technological equipments machineries, facilities and work installations)” 170.600
2813,,Installations and means of transport amortization” 51.180
119.420

6583,, Costs concerning delivered assets and other capital operations”

Case 1.2: Disposing the installation when this was reevaluated

Recalculated amortization: Reevaluated value: 197200 RON, 8 years remained lifetime

Annual amortization= 197200/8 = 24650RON/year

1. Registered amortization costs

6811,, Operating charges concerning depreciation of fixed assets” = 2813,,Installation and means of transport amortization” 24.650

2. Installation sale

461,, Diverse debtors” = 7583,, Incomes from assets’ sale and other equity operations” 188.000

3. Management discharging

% = 2131,,Technological equipments machineries, facilities and work installations)” 197.200
2813,,Installations and means of transport amortization” 24.650
172.550

6583,,Che Costs concerning delivered assets and other capital operations”

The impact upon the result of installation’s selling operation both in the case when reevaluation is not made and also in the case when it is done:

Table no.2: The incidence on the result of installation’s selling operation when it is not reevaluated, respectively when it is reevaluated:

Incomes and costs of selling operation	Case in which the installation is not reevaluated	Case in which the installation is reevaluated
Selling incomes	188.000	188.000
Costs concerning delivered assets	(119.420)	(172.550)
Result from selling	68.580	15.450
Costs concerning amortization	(51.180)	(24.650)
Incidence on the result	17.400	(9.200)

Source: own creation

The decrease of profit may be observed from selling the reevaluated installation. This decrease may be compensated by transferring the excess from reevaluation to the reported result, in the moment when the selling process takes place.

105 „Reevaluation reserves” = 1175,,Reported result 60.720
representing the excess realized from reevaluation reserves”

Following such operation, undistributed profit will be 60.720 when the installation is reevaluated, and the impact upon the result will be 51.520 (60.720 – 9.200); in the situation when the installation is not reevaluated, the impact on the result remains the same 17.400, and there is no undistributed profit.

Case 2: The impact of reevaluating the smoke chamber on the amortization, respectively on the result.

Table no.3 Technical installation presentation

Nr. Crt.	Fixed asset name	Input value	Normal lifespan	Amortized duration	Amortized value	Net value (unamortized)	Fair value
1.	Smoke chamber	185.238	20	4	37.047	148.190	203.762

Source: own creation

In the case of S.C. EXAMPLE S.A, smoke chamber was reevaluated at 203.762 with 110% index update representing the fair value, also taking into consideration its physical and moral usage. The difference from reevaluation is registered, consisting in an increase of reserves from reevaluation.

The updated accounting value = The outdated accounting value x update index = 185.238,66 x 110% = 203.762,526

The cumulated amortization updated value = the outdated amortization value x update index = 37.047,732 x 110% = 40.752,505

Table no.4 Comparative presentation of technical installation in the situation when it is not reevaluated, respectively after being reevaluated

	Before reevaluation	After reevaluation	Differences
Input accounting value	185238	244515	59276
Cumulated amortization	37047	40752	3704
Net accounting value	148190	203762	55571

Source: own creation

Accounting registration of evaluation process

212 „Constructions”	=	%	59.276
		105 „Reevaluation reserves”	55.571
		2812 „Constructions’ amortization”	3.704

Smoke chamber reevaluation leads both to an increase of amortizable base from 185.238 RON before reevaluation to 244.515 RON after reevaluation, and also to an amortization increase from 37.047 RON to 40.752 RON. Increasing amortization costs has effects on diminishing the result.

Starting from the fact that the remained useful life period of the tangible assets is 16 years, afferent amortization costs to each financial exercise are calculated:

Amortization costs for the situation when the smoke chamber is not reevaluated:

Net value / lifetime=148.190/16=9.262 RON

Amortization costs for the situation when the smoke chamber is reevaluated:

Net value (fair value) / lifetime=203.762/16=12.735

By comparing the amortization costs in the two cases, one can observe their increase after reevaluation.

Solution 1: amortization costs will be fully taken by the next exercises’ corresponding results for the next 16 years, using the operation:

6811 „Operating expenses concerning tangible assets amortization”	=	2812 „Constructions’ amortization”	123.735
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Solution 2: Amortization supplement of 12.375 - 9.262 = 3.473 will be taken by reevaluation reserves, using the operation:

%	=	2812 „Construction amortization”	12.735
6811 „Operating expenses concerning Tangible assets amortization”			9.262
105 „Reevaluation reserves”			3.473

The results of fixed assets reevaluation may have medium or long term consequences on the result, leading to an increase of taxable base and therefore to an increase of amortizations, with effects on diminishing the result.

6. Conclusions

Tangible assets' reevaluation, through the differences resulted from reevaluation, through the influence it has on the amortization's calculation base, the influence on the entity's result, leads to some "embellishment" of balance. These means constitutes techniques and procedures of creative accounting.

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