

## The Use of Accounting Information as a Means of Fraud

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### Abstract

*Accounting information plays an important part in the economic book-keeping/registration system in general, but also in the economic information system especially for decision making necessary for the business.*

*Although accounting information are available for a wide range of users – stakeholders, four principal qualitative characteristics must be met for the accounting information to be useful in the management system: understandability, relevance, reliability and compatibility of information.*

*Unlawful tax evasion involves deliberate violation of the tax law and is legally punishable by imprisonment.*

*The auditors also play a role in the fight against fraud and should help Member States fulfill their obligations to prevent, detect and correct irregularities and fraud.*

**Key words:** accounting information, unlawful, fraud, evasion, compatibility of information.

**J.E.L. Classification:** M41, M48.

### 1. Introduction

Economic information is of particular interest for accounting. Accounting information belongs to this category. It is obtained by specific methods, procedures and instruments for processing economic data. It is the most real, accurate, complete and operative information representing in fact the support on which the management process is based. Most of the decisions that are made in the process of work rely on information obtained from accounting.

Auditors have a key role in the formulation of an opinion on the effective functioning of management and control systems of the operational programs co-financed by ESIF. International Auditing Standards states that the primary responsibility for preventing and detecting fraud lies with both top management and those responsible for governance of the entity.

On the other hand, the auditors also play a role in the fight against fraud and should help Member States to fulfill their obligations to prevent, detect and correct irregularities and fraud.

Auditors need specific training directly related to their role in combating fraud. Thus, real cases and situations should be used.

The procedure consists of a working group composed of experts from Member States and representatives of OLAF, Regional and Urban Policy General Directorate, Employment, Social Affairs and Inclusion General Directorate, Maritime Affairs and Fisheries General Directorate. They work for a year on a specific topic chosen by the Member States.

Accounting information is produced by specialized structures, organized within the enterprise in the form of distinct functional compartments, or outside the unit as independent legal entities, as well as certified freelancers whose principal activity is to obtain these accounting information.

Managerial accounting information is for internal users or the entity's management and includes information on the unit cost of products, cost behavior relative to the volume of business or profitability per product.

## 2. The importance and definition of accounting information as a means of combating fraud

According to the well-known American scientists B. Needles, H. Anderson and I. Coldwell, (Needles B., Anderson H., Caldwell J., 2000, p. 319) "the information provided by accounting represent the basis on which decision-making process rely both inside and outside the company", stating that the purpose of accounting information - "to provide the basic data needed by different users to take fundamental decisions" - is an ideal. The difference between ideal and real, is the most interesting and controversial part of accounting.

In the context of contemporary developments of any company's activities, evolution of the market economy, its increased complexity led to a corresponding development of the economic and financial information. This type of information characterize the financial situation of a company, the results of its economic and financial activity, the use of human and material resources, both for its own needs and for third parties (shareholders, customers, banks, tax institutions, other natural or legal persons).

The audit is generally a systematic process of obtaining and evaluating objectively information or statements in order to assess their degree of compliance with pre-established criteria, as well as the communication of results to interested users. (AAA) Audit consists of a set of interconnected tasks (a process) carried out by the auditors or by other experts who, based on their theoretical and practical knowledge and after assignments from specific organisms, analyze the information and operations of an entity or related to certain activities in order to provide assurance through the formulation of opinions or recommendations (Oprean, 2002,p.36).

The convention, drawn up under Article K.3 of the Treaty on European Union, on the protection of the financial interests of the European Communities (Official Journal of the European Communities, 1995, p.49), defines "fraud", in terms of cost, as any act or deliberate omission related to:

- ✓ using or presenting false, incorrect or incomplete statements or documents, which results in misappropriation or improper retention of funds from the general budget of the European Communities or the budgets managed by or on behalf of the European Communities;
- ✓ nondisclosure of information and violation of a specific obligation, with the same effect;
- ✓ the misuse of such funds for purposes other than those for which they were originally granted.

ACFE divides fraud into three types, as a starting point for an organization to identify areas vulnerable to fraud:

1. Intentional manipulation of financial statements (e.g. incorrect reporting of revenue)
2. Any type of misappropriation of tangible or intangible assets (e.g. fraudulent expense reimbursements)
3. Corruption (e.g. bribery, manipulation of bidding procedures, undeclared conflicts of interest, misappropriation of funds).

There are three elements that underpin committing fraud, which can be summarized as a "fraud triangle" (Harry Cendrowski, James P. Martin and Louis W. Petro, 2007, p.41):

"fraud triangle "



- ✚ opportunity – chance
- ✚ rationalization – justification
- ✚ financial pressure –financial burden

✓ **Opportunity:** Even if a person has a reason, there must be an opportunity. Inefficient internal control systems may create an opportunity (*the presumed likelihood of fraud not being detected is a crucial consideration for the fraudster*).

Fraud can also occur if controls are not performed or persons of authority create opportunities to override existing controls.

✓ **Justification:** A person can formulate a justification by reasonably explaining their acts, e.g. "it is fair to do this - I deserve this money" or "they owe me", "I'm just borrowing the money - I will return them."

✓ **Financial pressure, inducement or motivation:** „need or greed” factor. Pure greed can often be a strong reason. Other pressure can arise from personal financial problems or personal vices such as gambling or drug addiction.

### 3. The facilitating factors of fraud

Factors that generate and favor the tax evasion phenomenon, both in its "*permitted*" and not sanctioned by law form and the one sanctioned by the law, may be grouped, for a better systematization, in:

✓ **psychosocial factors**, relating both to the inner impulses and beliefs of the taxpayer and the general conduct and social environment to which he belongs;

✓ **economic factors**, related to the taxpayer's perception of the level of income remaining after payment of taxes and its ability to meet the individual needs of the taxpayer;

✓ **legal and administrative factors**, related, on the one hand, to the perception of how the taxes are decided, the equity of tax system and the perception regarding the destinations chosen by the government for the revenue collected from taxes, and, on the other hand, to the taxpayer's perception on how the state institutions apply tax laws and any penalties arising from failure to comply with them.

There is an original factor of any tax avoidance: the inclination of taxpayer, of human being, for tax evasion (Hoanta, N., 1997,p.77) though not always he acts on it.

All these factors have a combined action on the decision to avoid taxation, so drawing a clear line of each person's action is both difficult and inappropriate.

Therefore, we believe that the recourse of a taxpayer to tax evasion, or not, is an internal option, personal to each taxpayer, which is in correlation with his perception on some exogenous variables, taken as a whole.

Imperfect integration of tax in social life derives, according to some authors, from the gaps in the fiscal education of people. In this regard, in the 40s, (C. N. Tautu, 1940, p. 23) wrote about this education of Romanians at the time: "Education of our taxpayer is nowadays so poor that he has only one concern: how to pay less and if, he could, not at all."

Unfortunately, even today, the Romanian taxpayer's mentality remained the same. Profession, religion and marital status may also bear relevance on the decision to commit tax evasion.

The volume of revenues may rise even by reducing the tax rate but only applied to a greater amount of the taxable income. ( Pestieau, M.,1991, p. 65)

It must be said, however, that the scenario of a policy of fiscal relaxation, of liberal inspiration, can lead to two opposite impulses. Thus, the decrease of tax level can lead to a reduction in the black economy, especially in tax evasion, undeclared work and fraud, or, on the contrary, of regulation, as effect of a policy of fiscal relaxation, it may lead to the encouragement of underground practices, which are less constrained and controlled. (Craiu, N., 2003, p.91).

### 4. International legal issues and fraud methods

Tax evasion is the logical result of the flaws and inconsistencies of an imperfect legislation, faulty methods of application and the incompetence of legislature, whose excessive taxation, for example, can be considered as guilty as those it provokes thereby to evasion.

According to the author, Vasile Bîrle (Birle, V., 2003,p.98), in the modern world, tax evasion has become a phenomenon, even a scourge in many countries, which grinds the economy, devours it from the roots, stifling it without giving any hope .

We believe that regardless of how it is defined this phenomenon; tax evasion is, finally, the failure to pay tax obligations, in bad faith, by the taxpayers.

The most common method of legal tax evasion is the existence of *tax havens*.

The name of tax haven tends to be replaced today with that of international financial center or financial paradise due to the numerous benefits granted to foreign investors in several domains, not just the taxation. Tax havens' aim is to attract foreign investors, who, benefiting of large facilities granted by these countries, will invest huge financial resources in certain business which will bring substantial benefits to the level of the country, thereby ensuring its development.

In the opinion of Grigore Lăcrița(G., Lacrita,2006,pp.42-43), the fiscal paradise is a country or a geographical area with an almost non-existent tax regime and a high degree of fiscal discretion or an area where tax obligations can be suppressed in full legality and almost impossible to control.

The number of international companies that have reported incidents of fraud increased by 22% over the past two years, according a study conducted by the first 4 audit companies in the world.

Although there were implemented new procedures to control fraud by the corporations, fraud is still widespread, difficult to be prevented and, in terms of its detection.Frauds were found in 45% of the companies .

Besides the premature revenue recognition, other methods were applied when these revenues were recorded on the basis of fictitious sales or nonexistent customers. Boston Japan, a supplier of medical equipment, recorded sales of USD 75 million in the period 1997-1998 from fraudulent sales - the company's sales managers leased commercial deposits, recorded false sales to distributors and delivered cargo to rented warehouses. The company has concealed that distributors have never paid those assets by issuing invoices by reversing to those and then recording other sales of the same goods to other distributors, but without moving the goods from the rented warehouses.

Company employees even recorded sales to distributors not involved in the field of medical equipment, but who had agreed with the company's sales executives to be part of this fraud.

Another method is to record transactions that occur between companies but in the end they present no economic benefit for any of the companies. For example, if a company gives a customer a loan so he can buy company's products, it is part of such a scheme if the loan was given for never being repaid. These transactions have the sole aim of increasing sales revenues.

## 5. Conclusions

Users of accounting information act, operate and make decisions constantly, by using and understanding the accounting information provided by financial statements.

International Auditing Standards states that the primary responsibility for preventing and detecting fraud lies with both top management and those responsible for governance of the entity.

Audit authorities of the Member States bear the responsibility, stipulated in their professional status, for two main types of audit: system audit and audit of operations. These two types of audit have different fields of interest and, therefore, prevention and detection of potential fraud will be examined separately.

Propensity to tax evasion exists in every individual from whom the governmental authority takes some of the income that belongs to him by law, and therefore he perceives this, first and foremost, as an attack on his welfare and freedom to enjoy the fruits of his labor.

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