

Motivations in Choosing Creative Accounting Techniques: A Managerial Perspective

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Abstract

The business world is a competitive one. Thus, managers tend to present their activity and of the company they represent in the best terms possible, so the stakeholders, present and potential, to have the best impression regarding that activity. Because numbers represent the main language of businesses, changing the accounting figures tends to be the easiest way by which managers present the most favorable situation of the company they represent, through the hands of the accountants. The temptation to resort to creative accounting techniques increases, managers being attracted by solutions to protect them in less favorable times. The desire to have better results and bigger bonuses outlines a starting point from which all other problem begins. Through this paper we aim to establish the boundaries of creative accounting and the reasons invoked by professionals.

Key words: creative accounting, stakeholders, creative techniques, motivations.

J.E.L. classification: M21, M4, M42

1. Introduction

In the life of a business, as in a man's life, there are good days and bad days, periods of abundance and others of recession, conditions in which it is difficult to maintain investors' confidence in the business performance. The temptation to engage in creative accounting techniques increases, managers being attracted by solutions to protect themselves in less favorable times. The desire to have the best results and the highest bonuses outlines one point from which all the other problems begin.

Usually this term is associated with a good, positive thing, a feature that differentiates people and gives them an unique character. We are glad to see a shadow of creativity in our children and we'll do anything to develop it into something great. This doesn't apply for the accounting field where creativity is usually seen as an undesirable habit, as a negative technique. „Why we do not see creativity in accounting as something positive?”, “Why do we do anything to stop it?” are just few of the questions we are seeking to answer through this paper.

2. Creative Accounting, from motivations to objectives and strategies: a literature review

The expression „creative accounting” was introduced for the first time in Anglo-Saxon environment, being used by those who supervised and commented the activities of capital markets (journalists and financial analysts). Subsequently, it was taken over in the vocabulary of other countries, which led to the multitude of terms that describe it today (Ionaşcu 2003, p.161). We could say that the debates on this topic have intensified alongside the scandals that shook the business world and will continue to do so, given that the removal of the premises allowing the use of creative techniques is far from disappearing from the economic world.

Creativity is a red line in the evolution of accounting, and that can be seen from two different perspectives. One, the positive side, is the source of evolution in accounting and accounting profession. The complexity of the business world has always been a challenge for the professionals,

and only their creativity has allowed accounting to evolve to its present form. Second, the same business world has created competition, charts and wealth. These are sources of the grey side of the creative accounting. Later, these motives have evolved into objectives and strategies, which have led to different techniques, presented below.

Amat and Blake (1995, p.3) present creative accounting as a process by which accountants use knowledge about accounting rules to manipulate a company's accounts, and introduce in their paper four books, published on the subject, each from a different perspective:

- from the perspective of a business journalist: Ian Griffiths, in *Creative Accounting*, notes that all businesses in a country hide their benefits. The annual accounts are based on registers that were "finely cooked" or "completely fried" and the reports have been completely changed to protect the supposing guilty persons. The author claims that creative accounting is the biggest hoax since the Trojan horse and that, really, it is a completely legitimate fraud.
- from the perspective of a professional accountant: Michael Jameson argues, in *A practical guide to creative accounting*, that the accounting process involves working with different types of opinions and solving conflicts between different approaches to present financial results and transactions. The author believes that this flexibility facilitates manipulation and deception. These activities performed by unscrupulous members lead to what we call creative accounting.
- based on his experience in the field, Terry Smith, an investment analyst, states, in *Accounting for growth*, that much of the apparent growth in the 1980s was more of a "hands-on game" than real economic growth.
- from the point of view of an academician, Kamal Naser defines creative accounting, in *Creative financial accounting: its nature and use*, as a transformation of financial accounting information from what it really is, in what it wants to represent, taking advantage of existing rules or ignoring some of them.

There are four different interpretations, from four different perspectives. Yet, closely analyzed, there are two common elements: describing the incidence of creative accounting as common and seeing it as a lying and unwanted practice (Amat et al. 1995, pp.4–5)

Regarding creative accounting techniques, Amat and Gowthorpe (2004, pp.7–8) show that the potential to use creative accounting techniques lies in six areas: the flexibility of regulations, the lack of regulations, the existence of management opportunities for future prospects, the timing of certain transactions, the use of artificial transactions, and the reclassification and disclosure of financial information. Stolowy (Feleagă 1996, p.148) divides the creative accounting techniques, according to the pursued objectives, into three types: techniques with impact on the income measurement, techniques with impact on cash-flows, and techniques with impact on the balance sheet. Jones (2011a, pp.44–45) also proposes five *strategies* around which creative techniques revolve: revenue growth, expenditure reduction, asset value increase, debt reduction, and cash flow increase.

Whether we are talking about manipulating earnings (in the form of growth or minimizing them), smoothing them to eliminate fluctuations, or balancing financial statements, there is always a reason why managers choose this path (Ciocan 2017, p.453). Jones (2011, p.31) states that, in a perfect world, there is no reason to call for creative accounting or fraud: the results would be excellent, the bonuses and the price of the shares would be high, and the financial operations would be in line with both the managerial and users' expectations. But we are not perfect, the world we live in is far from perfection and accounting is not an exception to this rule.

The appeal to creative techniques must be justified and among the most often cited reasons found in the literature, we find: the possibility of obtaining certain tax benefits, the access to loans or other similar facilities, meeting the expectations of the stakeholders, maintaining the price of shares, thus reassuring investors of the well being of the entity, positioning the entity favorably in less favorable times, etc. (Ciocan 2017, p.453). As a rule, those who engage in these practices are expecting certain benefits, rewards from them. Mulford and Cominskey (2002, p.4) present a series of rewards that fall into four major categories:

- share price effects (higher share prices, reduced share price volatility, increased corporate valuation, lower cost of capital, increased value of stock options);

- borrowing cost effects (improved credit quality, higher debt rating, lower borrowing costs, less stringent financial covenants);
- bonus plan effects (increased profit-based bonuses);
- political cost effects (decreased regulations, avoidance of higher taxes).

Jones identifies three broad categories of reasons for managers to justify recourse to these techniques and detail them as presented in Table 1

Table no. 1 Reasons that justify manager's recourse to creative accounting

Category	Motive	Explanation
Personal Reasons	Increased salaries	In some cases, managers' salaries are conditioned by the achievement of certain goals or results, which causes them to resort to these techniques.
	Bonuses	Usually bonuses are conditioned on certain results, in which case managers are drawn to modify them for their own interest.
	Shares and Share Options	This reason is cited most often in countries with strong capital markets, like the United Kingdom or the United States. There is a directly proportional relationship between profit and the price of shares, which makes a high profit company to also have a good price for its shares and one with weak profits to be disadvantaged from this point of view. In this case, managers are attracted to use creative accounting to achieve a high profit and thus a good price for the shares.
	Job security	Managers also look for job security. The question which arises is: „Why should I be at risk of losing my job if there is a possibility of arranging the results according to the investors' expectations?“
	Personal satisfaction	In order to explain this reason, Jones brings into question human nature. It is in our nature to expect gratitude, honor, and appreciation. Managers are also people, and self-esteem often prevents them from reporting the real situation of a company and exposing them to criticism, thus resorting to creative accounting techniques.
Market Expectations	Compliance with the expectations of financial analysts	In addition to annual reports, there are quarterly reports and in some cases some additional information on future results. Based on past results, current information and some factors, financial analysts predict a certain level for future earnings, and if for some reason these projections do not occur, stock prices may be affected. For managers who are paid according to the share price it is a disadvantage that can be prevented by using creative accounting.
	Profit Smoothing	Long-term strategy to maintain consistent earnings is also a reason for applying creative accounting techniques. A company with fluctuating results will be considered more risky and will give the impression that is poorly managed, while one with consistent results will provide certainty to investors.
	Trends	Starting from the premise „if everybody does it so can I“, some managers use these techniques to be in trend with other managers who use them.
Special Circumstances	Manage Gearing and Borrowing	Companies often borrow money, for which loan contracts are concluded. Most of the times in these contracts there are clauses that imply the stability of some economic and financial indicators or results that, once violated, bring the company into the situation of paying penalties or even immediately reimbursing the credit. By maintaining contractual parameters within the limits, using creative accounting when it is not otherwise possible, managers keep the company away from possible penalties or even more severe cases of economic destabilization caused by reimbursement of a loan before the deadline set by contract.
	New situations	There are mainly two moments considered in this context: when a company is listed for the first time on the Stock Exchange and when a company wants to raise more money through a share issue. In both cases, creative accounting is used to make the company's results look better than they really are.

Category	Motive	Explanation
	Mergers and acquisitions	In this case there are two points of view: the one of the bidder and the one of the target. From the perspective of the bidder, a good set of results will allow the bid to be made from a position of strength with a high price of shares. Referring to the target company, the bidder will have to pay more, if the reported income reaches a certain level.
	New management team	When the leadership of a new company changes, management tends to blame old managers for all the poor results. A so-called "big bath" technique is adopted, whereby poor performance will be made even worse by allowing managers to start from a low performance and increase future results.
	Waiting for the good times	There are situations when a company is very weak, but has expectations for future periods. Through certain creative accounting techniques, these companies avoid delisting from the stock market.
	Believing that current regulations are incorrect	A fairly rare case is when the managers want to give a true and fair view, but believe that current regulations prevent this from happening. Thus, they believe that, by adopting a more liberal, more creative way of keeping the books, they will be able to deliver the fair view.
	Decrease regulatory visibility	Some companies such as those dealing with oil processing, water distribution, telecommunications, and other activities that could be subject to government intervention should not stand out with huge profits; the creative accounting techniques are used in this case to decrease the reported results.
	It is not illegal so why shouldn't we use creative accounting?	A final reason is that creative accounting is not illegal. This reason is more of an incentive than a purpose. Therefore, as managers are not doing anything wrong, why shouldn't they use creative accounting? This is a perfectly legitimate argument, even though it is not necessarily following the spirit of the regulations. The fact that they may believe others are also adopting creative accounting reinforces this argument.

Source: Own processing after Incentives for creative accounting and sometimes fraud, (M. Jones 2011b, p.33)

Analyzing the Table 1, we can observe that the reasons can be splitted in two: personal and the ones related to promoting the company. In the eyes of the accountants, creative accounting based on explicit motives of self-interest can attract more disapproval than where the motivation was to promote the company.

Following Jones's reasons, we can observe that these can be invoked especially in countries with a predominantly Anglo-Saxon culture, where the financing of companies' activities is mostly made through capital markets and are is „disconnected” from taxation. Because the accounting field is subject to normalization, there are differences when it comes to continental countries. The strong connection between accounting and taxation is one of the major differences that can be observed in this context. Taxation is, therefore, a factor contributing to the use of creative accounting techniques, given that taxable profit is calculated on the basis of accounting reports (Amat et al. 1999, p.120). If we determine the reasons why creative accounting can be used, we must also take into account its impact on the actors involved in the life of an economic entity. For this purpose we present in table no. 2 the potential gains and losses for all those involved in business life.

Table no. 2 Potential losses and gains for actors involved in the life of an economic entity

Gains	Losses
Managers	
Keeping their job; Reducing the cost of capital; Managing their remuneration; Minimizing the income tax; Improving the relationship with creditors, investors and employees; Declaring and paying steady dividends; Presenting constant results (income) from one period to another; Well passing of the official examination; Respecting debts covenants	Their job Their reputation

Gains	Losses
Existing shareholders	
Increasing their wealth; Increasing the market value of their shares; Reducing the cost of capital; Controlling employees' claims	Confidence in the market
Existing bondholders	
Increase the market value of their shares Controlling employees claims	Wealth transfer to the actual shareholders
Employees	
Keeping their jobs; Increasing their remuneration, especially in the case of profit share payable to employees	Their jobs due to bankruptcies
Suppliers	
Keeping their clients	Money owned due to bankruptcies
Clients	
Providing continuous services; Respecting warranties	Services interrupted; Warranty not honored
State	
Tax to collect; Jobs for the people	No more tax to collect Expenses with the unemployed
Financial creditors	
Repayment of the loans	Money due to bankruptcies
Society	
Jobs; Wealth for the economic environment	Jobs lost as a result of bankruptcies

Source: Own processing after (Stolowy & Breton 2004, pp.41–42)

As we can see in table no.2, we cannot talk only about benefits for those involved, especially those accountable with the entity's management. However, the list of benefits is visibly longer and more attractive, which is why managers are tempted to use these techniques in order to build the desired image of the company's results.

3. Conclusions

Even if it involves risks such as losing their job or even worse, losing their reputation, creative accounting practices remain attractive for managers. Starting from the premise „I'm too good to be caught”, managers choose to position themselves favorably most of the time. Often the choice is a simple one (the smallest evil): either they lose their jobs, being penalized by stakeholders for poor management, or they lose their jobs if they are found to use creative accounting techniques. Detection of such techniques involves advanced specialized knowledge from those who examine the financial statements, but there is a small risk of being observed by investors, who often do not possess such knowledge. Making understandability an enhancing characteristic of the accounting information helped this process, because information can be presented, even if it is not understood by all the users.

Another conclusion which can be drawn is related to the ethics of creative accounting: it is possible that, if the reasons or motivations in applying the creative techniques are related to promoting the company and not to self-interest, the thin line between ethical and unethical behavior to be blurred? This is a question to be answered in future research.

Regardless of the reasons given by the entity's management, the use of these techniques should not be used under the auspices of „purpose excuse the means” as they reduce the reliability of accounting information.

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