

## The Determining Factors of Creative Accounting

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### Abstract

*The present article is a structural analysis performed on a set of specialized articles on the topic of creative accounting, an analysis carried out in order to identify the factors that determine the use of accounting engineers and the most important measures that can be taken into account for combating or little minimization of accounting engineers.*

*The analysis was performed by coding the key words and expressions and grouping them on the most important factors that determine the application of the creative accounting: the professional accountant's profile, accounting rules, ethical principles, pressures and the financial economic crisis.*

*Structural analysis was also performed to identify how creative accounting is perceived, respectively the positive and negative aspects of using accounting practices.*

**Key words:** creative accounting, true and fair view, fraud, legal, illegal.

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### 1. Introduction

Taking into account IAS 1 standard "*Presentation of Financial Statements*," the financial statements of an entity must present clearly and concisely the financial position, performance and treasury of the entity. To achieve this objective, it is necessary to faithfully represent the effects of transactions, other events and conditions in accordance with the criteria for recognition of assets, income and expense.

The truth of accounting is a truth built in accordance with a set of principles, basis of assessment, rules, conventions and specific practices. Often, however, accounting truth appears at the intersection of a compromise between information producers, financial auditors and information users. From this compromise, the construction of accounting truth outlined the "*problem of the approach between creative accounting and regulatory (normative) accounting, between a principle-based accounting and a rule-based accounting, between accounting innovations and accounting manipulation, between regulatory truth and the desired truth, between virtuous accounting and perverse accounting*" (Ristea M., 2008).

Financial situations are often transformed from what they need to be to what they are doing, in order to get benefits from existing principles or rules, or by knowingly ignoring some of them. In order for the accounting information to be true, it must comply with two principles, the principle of compliance with accounting rules and the principle of sincerity. The first principle implies that accountants comply with all general principles and regulatory provisions, while honesty is the application in good faith of rules and procedures based on the knowledge that accountants need to have on the reality of events and transactions.

The principle of sincerity implies the application of the principle of relative importance in accounting. Only the good faith of the accountant can certify in such cases the fidelity of the image. Due to the optional nature of recommendations from national and international regulatory bodies, there is a margin of uncertainty. The fidelity of the enterprise image is the qualitative criterion of normalization. It can not be said that the image captured by accounting is the "correct" because this word also has the "precise" connotation, whereas the accounting information still depends on the appreciation of the accountants and auditors, an appreciation that has a certain degree of subjectivity. In accounting, the expression "true image" has the expression "true and fair view" in English.

Michael Capron has accredited the idea that reality can be presented through several faithful images, as there may be more photographic representations of the same subject depending on the angle of view, light, distance, and consequently to choose what is to the greatest extent according to the law or according to the given situation. It is the problem that users of less experienced accounting information do not confuse the image with reality due to lack of accounting experience, and be perfectly aware of the distance that exists between the two in order not to generate an accounting illusion themselves. (Ristea M., 2008).

The main source of information needed to make decisions within a company is accounting. The accounting information presents the factual status of an entity, the performance and changes in the financial position of an entity. It is the starting point in making managerial decisions. Through the creative accounting techniques implemented, accounting information is modified in the desired sense precisely to mislead aspects regarding the performance and financial position of an entity.

The management of the economic entity is the one that, using the accounting engineers, respectively the creative accounting, transforms the financial statements from what they should reflect into what they want to present.

According to International Accounting Reporting Standards, the accounting information, in order to be of the respective quality and to present the financial position of an entity, must be real and correct, respectively comparable, intelligible and verifiable.

If an economic phenomenon can be described in several ways, the auxiliary characteristics of an information such as verifiability and comparability are those which help to choose one way to the detriment of another, increasing the usefulness of the accounting information.

## 2. Literature review

The first mention of creative accounting belongs to Luca Paciolo (Balaciu Diana, 2010). In his famous "*Summa of Arithmetic, Geometry, Proportion and Proportionality*" he presented the first creative accounting techniques. In Venice, in a highly developed foreign trade, economic relations between traders were recorded in accordance with the principles of double-entry bookkeeping and were recorded in main and secondary registers. When there were inconsistencies between the two registers, ink was poured over the registers, but not by accident but willing to make the records illegible.

Lainez and Callao (Lainez & Callao, 1999.p.20) consider creative accounting as the accounting generated by the use of techniques such as the options, subjectivism and gaps in the norms provided by the accounting legislation in order to present financial statements reflecting a desired image and not an objective picture of reality.

Gowthorpe and Amat (Gowthorpe & Amat, 2005) consider that "*those who prepare the financial statements can manipulate the image of the economic reality presented to those interested through these documents.*"

According to another opinion developed by Blake and Bond (Blake & Amat, 2000) accounting professionals are those who, based on the necessary experience, manipulate in the desired sense the figures published in the accounting reports of a company

Another definition of creative accounting is that stated by StahAtul (Stah, 1998) that "*creative accounting is the process by which management takes advantage of the shortcomings or blurring in the accounting rules to present a modified image of financial performance.*" *It respects the letter, but obviously not the spirit of the law*".

Raffourinier (Raffournier, 2003) understands by creative accounting "*the use of flexibility and gaps in accounting regulations to present the financial statement of the enterprise in a manner different from that which would result from the normal application of existing rules.*"

A detailed definition of creative accounting is given by Naser (Naser, 1993) which brings to the fore the idea that accounting engineers are violations of the rules, they are accounting manipulations that allow the transformation of summary documents into accounting reports desired by managers. The flexibility of the accounting rules is what allows the accounting professionals to structure the information in such a way that they allow to produce the desired result.

According to Stolowy (Stolowy, 2009) creative accounting departs from two aspects: tracked goals and procedures used to manipulate information. According to this author, the objective of creative accounting is to modify accounts in the sense of improving or "deteriorating" them when the goal is to reduce or minimize the results and implicitly reduce the tax. Use of creative accounting techniques can also be achieved when there is no precise objective or when the accounting rules do not provide solutions for the situations in practice.

The term creative accounting in Romania was first approached by Professor Niculae Feleagă who provided information on the dimensions and limits of creative accounting. He stresses that accounting engineers have contributed to the rise of the contemporary crisis.

Another author Malciu (Malciu, 1999) in his book entitled "*Creative Accounting*" emphasizes the challenges of creativity by looking for solutions to limit its use.

An important contribution in defining the concept of creative accounting belongs to the authors (Feleagă, 2002). They are the ones who highlight both positive and negative aspects generated by practicing creative accounting. His book is structured in two sections, the first part highlights the benefits of using the accounting options and policies correctly, the second part reflects the negative aspects of accounting engineering accounting, also indicating reasons for the emergence and development of creative accounting providing solutions for fighting it.

In his paper, Cernusca (Cernuşcă, 2004) emphasizes that the pessimistic or optimistic attitude of the accounting professional is the one that contributes to the foundation of the accounting policies by determining the content of the annual financial statements and the desired result.

In Diaconu's view (Diaconu, 2004) the creative accounting phenomenon derives from managers' desire to further increase wages, managers will always be interested in exerting pressure on them.

In Patroi's view (Pătroi, 2006) the creative accounting techniques are accounting manipulations, they present negative aspects because they contribute to the distortion of the accounting result being a threat to the application in good faith of the accounting rules.

Ristea and Dumitru (Ristea M., 2008) define creative accounting according to the principle of prudence, presenting creative accounting techniques and practices regarding the assessment of tangible and intangible assets, problems regarding the evaluation of financial instruments, the measurement of inventories, the impairment of debts, etc

Dumitrescu (Dumitrescu, 2014) also highlights the positive and negative aspects of creative accounting. According to this author, creative accounting is a deceptive practice because it does not present the real situation and the economic-financial performance of a company. However, it is also regarded as a positive and beneficial technique as it proposes solutions to the financial crisis problems.

Balaciu (Balaciu Diana, 2010) conducts an empirical research on the Romanian area that seeks the perception of auditors and managers' attitudes about creative accounting practices. It uses creative accounting practices to ensure a positive image of the economic entity through the financial presentation. A more complex vision is Groşanu (Groşanu, 2011) who argues that creative accounting is the result of flexibility, which exists in the accounting regulations and if applied in good faith, allows to ensure a true image of the financial position and performance of the economic entity. Each user of accounting information pursues certain interests, and the flexibility of accounting regulations is often used to satisfy private interests to the detriment of the public interest.

### 3. Research methodology

This research highlights the way in which creative accounting is perceived by different authors, is a structural analysis performed on specialized articles that deal with the problem of creative accounting. The analysis was carried out on the concepts of creative accounting, accounting engineers, faithful image, fictional image, perceptions of accounting professionals, managers, auditors on creative accounting practices. The research allowed to identify the factors that determine and influence the creative accounting techniques and the grouping according to their importance and degree of influence.

Through the analyzed articles, through the accounting scandals we identified, I tried to highlight the problems of applying accounting engineers, to propose the most effective solutions to minimize the practice of creative accounting, and to emphasize that accounting engineers have several negative aspects. than positive ones, and only an accounting professional could understand the true value of accounting.

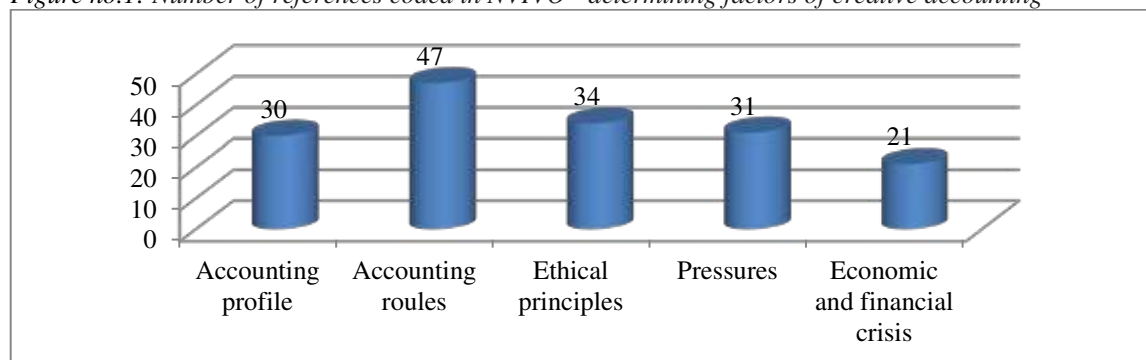
The research method used was the meta-analysis carried out on a set of 60 articles, from which we selected 10 specialized articles by the following keywords: creative accounting, , fraud, legal and illegal, true and fair view.

Following the meta-analysis, in order to identify the determinants of creative accounting practices, we established the following research directions:

- Identifying how creative accounting is perceived by accounting professionals, auditors, managers,
- What is the definition given to creative accounting and what are the factors that determined its appearance,
- What is the link between creative accounting and tax fraud, ethics and ethics?

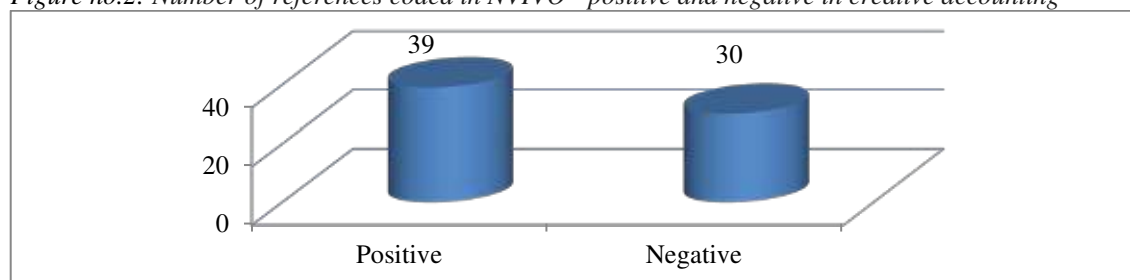
In order to identify the determinants in the application of creative accounting techniques, we have introduced the 10 articles analyzed in the NVIVO Qualitative Analysis Program in order to identify keywords and the frequency of their use. The content analysis of the articles was carried out by coding the keywords on the main topics of interest: identifying the factors that determine the use of creative accounting techniques and the positive and negative perception regarding the accounting engineers:

Figure no.1: Number of references coded in NVIVO - determining factors of creative accounting



Source: Authors' design

Figure no.2: Number of references coded in NVIVO - positive and negative in creative accounting

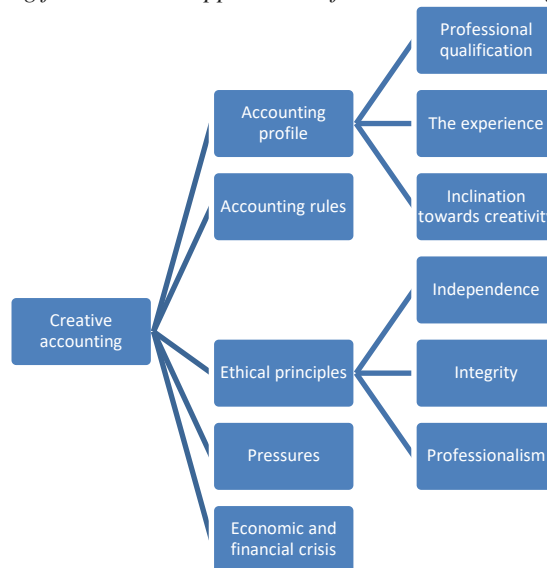


Source: Authors' design

#### 4. Findings

The content analysis performed on the specialized articles was aimed to identify the factors that cause professional accountants to practice creative accounting techniques. Taking into account the professional accountants' responses according to the established objectives, we can identify the following determinants in the application of creative accounting techniques.

Figure no.3 :The determining factors in the application of creative accounting techniques



Source: Authors' design

**The role of the accountant** in finding creative accounting techniques is essential.

A good professional accountant, with experience, with the skills and knowledge required in the field can at any time detect creative accounting techniques.

Managers prefer accounting professionals with **experience**, open to creativity and innovation, respectively those accounting professionals for whom creative accounting techniques do not represent a violation of the law or an unethical activity, but a set of optimized solutions and decisions designed to increase the profitability of the company.

Accounting professionals who practice creative accounting techniques fall into two categories: either they are inexperienced and they act in ignorance or they are accounting professionals with extensive experience practicing the profession for at least 10 years, usually women, with seniority in the company, with the necessary skills and knowledge and with a dose of ingenuity necessary to find solutions without violating the legal provisions.

**The accounting and fiscal legislation** in force is an important factor that influences and determines the application of accounting engineers. The creative accounting techniques are practiced in the highest weight due to: the insufficiently regulated accounting rules that allow room for interpretations, the gaps and inconsistencies in the accounting and fiscal legislation. The freedom to choose the accounting policies, the possibility to make estimates and forecasts, the permanent change in the social and fiscal environment determines the accounting professionals to practice creative accounting techniques. The existence of operations that are not fully regulated, complex situations arising in practice for which there are no regulatory norms, cause the accounting professionals to resort to their own reasoning in order to bring benefits to the company, respectively to the private interest at the expense of the public interest.

The biggest **pressure** comes from the managers, as they are the ones who decide whether or not to capitalize the interest expenses, how to calculate the costs of production, acquisition, what fixed assets are re-evaluated, what types of depreciation are approved. The decisions taken by the management of the company are brought to the attention of the professional accountant for their implementation, most of the times without the prior request of a qualified and competent opinion. The interests of the manager to maximize the profit, to transform the financial statements from

what they should be in what they want to reflect are priority. Other pressures come from investors looking for consistent earnings growth, so they are interested in "financial performance". The pressures are exerted both on the professional accountants and on the auditors. Above the auditors are manifested pressures of time, fees, competition, reputation. In conclusion, 37% of the respondents stated that they practiced creative accounting techniques taught by the management of the employer.

The notion of creative accounting has developed and accentuated in times of **crisis and economic and financial instability**, when many companies to overcome the difficulty, to be able to face the competition, have sought solutions, using mostly creative accounting techniques. Both creative accounting and tax fraud appeared under conditions of financial difficulty as a result of the volatility of some of the market elements, the interest rate increase, the inflation rate rise.

The **conduct, the compliance with good faith** of the accounting norms, the **morality** of the accounting professional, the auditor, the manager is an element that determines the application of the creative accounting techniques. Given that the temptations are high, the pressures are multiple, only professional ethical conduct, independence, integrity and professionalism are the qualities that cause the accounting professionals not to resort to creative accounting techniques. Ethics is absolutely necessary for the very existence of the profession, the auditors are those who must guarantee the observance of the law itself, but also of its spirit.

## 5. Conclusions

From the analysis of the references we can conclude that the main reason for resorting to creative accounting comes from the desire of managers to present a performing company, to improve the financial results of the company, to attract as many investors as possible. In the second plan we use creative accounting techniques for reducing taxes and fees, reducing fiscal pressure. Thirdly, creative accounting techniques are used to attract new sources of financing to cope with financial difficulties.

Creative accounting presents many **positive and negative aspects**, but meta analysis has highlighted more negative than positive elements.

As **positive elements**, creative accounting is a combination of methods and techniques, options and freedoms allowed by applicable accounting and tax regulations, without violating the law or accounting requirements that allow managers to improve their financial result or financial statements. Creative accounting is also a means used by companies to adapt, develop and become more competitive in an ever-changing environment. Creative accounting intelligently exploits legislation, so we do not have to deal with tax fraud.

In terms of **negative aspects**, creative accounting is the one that has led to numerous frauds, evasion, breach of accounting and tax regulations. Fraud is a synonym for accounting engineers, as both aim to create a distorted image of the company, showing it more prosperous, more attractive, misleading investors. Most organizations resort to such techniques for negative purposes, respectively to conceal reality or to present it in a modified form.

The truth said in half and the lie can be considered as susceptible to possible frauds, both have the ultimate purpose of misleading the external users of the synthesis documents from where the conclusion that fraud and creative accounting are similar notions.

Creative accounting practices will only disappear with the disappearance of the causes that have generated them, so the desire of professional accountants to restrict creative accounting should take into account the circumstances that allow it to emerge.

**The most important measure** for limiting or reducing the frequency of manipulations in the financial accounting activity is the presence of the audit within the companies. The audit and the control means remain clear elements for combating or limiting distortions in the level of financial-accounting information. The role of the audit is to express an informed opinion on the information publicly disclosed by companies, it must take a clear and firm position when there are signs of creativity.

**On the second level**, another measure to combat creative accounting is to remove the gaps in the norms, interpretations, limit the options, reduce the number of accounting processes allowed or clearly establish the circumstances in which each processing must be applied. All particular situations must be analyzed and interpreted separately on the basis of specific rules.

**An important measure** for combating creative accounting is creating accounting standardization bodies, competent bodies for arbitration and / or interpretation would also contribute to reducing creative accounting techniques.

From the references analyzed we can conclude that sanctions are not a measure for reducing creative accounting. Each time new laws are drafted or existing laws are amended, companies are looking for new solutions to avoid the system in order to minimize the impact.

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