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CREATIVE ACCOUNTING – OPTION OR NECESSITY

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Abstract: *Starting from the approach of accounting as a "social game", in which the main actors are on the one hand the providers of accounting information, and, on the other hand, its users, we can see that depending on the interests pursued by the management of the economic entity, the creativity of the accounting professional can be used both to seek new solutions to problems arising at a given time and to "beautify the financial statements". Thus, these manipulative accounting practices aimed at generating an image that is as convenient as possible for the entity, to the detriment of the true image, are known as* ***creative accounting****.*

Keywords: creative accounting, fair presentation, management of the economic entity

1. Introduction

The essential place and the role of accounting information in the architecture of the economic information system is a direct consequence of its extremely high degree of certainty and the qualities that characterize it: relevance, comprehensibility, credibility, and comparability. Therefore, as an essential tool and an important pillar of the process of elaboration, substantiation, and decision-making by all users of the accounting information, it is necessary that accounting information provides an accurate reflection of economic processes and phenomena, both at micro and macroeconomic levels.

In accordance with international accounting standards and the ***fair presentation*** principle, each economic entity must adopt the most appropriate accounting policies that ensure the most accurate reflection of the entity's economic reality in its financial statements. In the absence of an explicit rule needed to solve certain problems, the entity's management is obliged to use professional judgment to implement an accounting policy that objectively reflects reality and provides useful information to the recipients of financial information.

Furthermore, according to the international benchmark, a change in an accounting policy occurs if it is required by a standard or if it is performed in order to improve the quality of accounting information, its credibility and relevance in regard to the entity's transactions, financial position, and performance.

The complexity of the economic entity's business can create problems for which the accounting professional does not have clear regulations. Moreover, there may be several accounting options to find appropriate solutions.

The choice of one or other of these accounting options is perceived as a freedom for the accounting professional to interpret and, implicitly, apply it in the preparation of the financial statements, which generates the possibility of "cosmetizing" the results.

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This freedom in the choice of accounting options, combined with the flexibility of legal and accounting rules, can therefore be exploited to present the economic reality of the entity in a distorted manner, and this leads to the phenomenon of ***creative accounting.***

The starting point of our scientific approach is to review the literature on the concept of creative accounting and how it functions, in order to provide opinions and value judgments that support a thorough understanding of this topic.

Thus, we aim to present the parties involved in the application of creative accounting techniques, the motivational factors, as well as the effects of manipulating the performance of economic entities by resorting to these techniques.

2. The concept of "creative accounting"

Several authors in the field, both from Romania and abroad have tried to discuss the main elements of the concept of creative accounting.

In most cases, specialized literature presents a general view of creative accounting, focusing more on the deadlock that characterizes financial and accounting data presented in the financial summaries (balance sheet, profit and loss account, explanatory notes) and less on the techniques used to eliminate this phenomenon of number manipulation.

The concept of creative accounting has become a topic of great interest in the last half century. The specialized literature records the first reference to the concept of "creative accounting" as made by J. Argenti in 1973. It was subsequently reiterated under the names of "imaginative accounting", "accounting by design" or "aggressive accounting", because it involves manipulating accounting figures in financial statements and transforming them according to the obscure interests of the management of the economic entity, taking advantage of the existence of loopholes in the rules, of the flexibility of the rules, and of some legal and job-specific gaps.

The most complex definition, adopted and shared by many specialists, is the one presented by K. Naser in his paper "Creative financial accounting: its nature and use", according to which creative accounting is: *"The process by which, given the existence of gaps in the rules, accounting figures are manipulated and, taking advantage of flexibility, those measurement and reporting practices are chosen that allow the transformation of summary documents from what they should be to what managers desire"* [2].

Jean-Louis Malo and Henri Giot also argued at the 1995 AFC Congress that this concept should not automatically be perceived as something negative or perfidious, stating that *"at its origin, creative accounting is virtuous: it provides accounting with the means to keep pace with the growing development of markets and the proliferation of financial products. The problem stems from the fact that the instinctive perversity of business people is rapidly beginning to manifest itself"* [3].

These views, however, have not been embraced by a portion of the accounting profession elite; even more so, many diametrically opposed positions have been expressed. Thus, M. Jameson argues that the flexibility of creative accounting facilitates manipulation, deception, and misrepresentation and is practiced by less scrupulous members of the accounting profession. And even if creative accounting does not violate accounting rules and the law, it only respects the letter of the law and less the spirit thereof [4].

In Romania, the first seminal paper referring to the issue of creative accounting belongs to Professor Niculae Feleagă (1996). In his paper entitled *"Accounting controversies, conceptual difficulties and accounting credibility"* the Professor aims to review the main issues concerning the extent and limits of the concept of creative accounting.

Also, in the paper *"Prudence and agressivity in accounting treatments"* Ristea and Dumitru bring to light a discussion techniques and practices of creative accounting, regarding the assessment of body and non-body immobilizations the evaluation of financial instruments and the assessment of stocks and the impairment of receivables, etc [5].
In his research, Dumitrescu presents *"creative accounting both as a deceiving, manipulative practice of the financial situations and as a positive, beneficial technique aimed at finding new solutions to current accounting problems, in order to accurately present the financial positioning and performance of entities"* [6].
Balaciu (2012) conducts an empirical research in the Romanian space, focusing on the perception of the auditors and the attitude of managers regarding creative accounting practices" [7].
A comprehensive approach to the topic of creative accounting belongs to Groșanu, who tried to find answers to the main questions about the appropriateness and "morality" of using creative accounting in his paper *"Creative accounting"* [8].
In conclusion, the definition of the concept of creative accounting has been and continues to be a real challenge for professionals and academics, as confirmed by the many, often divergent attempts. However, we can state that, whatever the approach, there is a certain consensus in the definitions of the various authors that this concept does not imply any violation of legal provisions and that, although the result of creative accounting is the cosmetization of reality in order to serve certain financial interests, this does not go beyond the limit of credibility.

3. The rationale behind creative accounting

Based on the above statement, according to which creative accounting is a process of transforming accounting documents according to the wishes of managers, we will try to identify the main motivations of managers of economic entities in adopting creative accounting techniques.
The main identified reasons for adopting creative accounting are the following:
✓ excessive taxation, in conjunction with inaccurate, interpretable and unpredictable legislative provisions creates the prerequisites for creative accounting. The pressure from the state takes the form of excessive taxation, unpredictable, inaccurate and interpretable legislation that pushes management to the temptation of easing its tax burden;
✓ pressure from investors through management contracts lead to situations where managers are tempted to manipulate accounting information in order to achieve the indicators assumed in these contracts and obtain the set rewards and bonuses;
✓ the incompetence of the entity's management may constitute another reason for using creative accounting to mask incompetence by reporting satisfactory results and maintaining a good reputation. We point out that the use of these techniques is merely a postponement of the moment of truth, the decline of the business, and the end of the company;
✓ the economic context, generated by periods of crisis or strong competition, can determine managers to resort to procedures which, although ingenious, are at least questionable when employed to present the most attractive image possible;
✓ the use of creative techniques by managers to maximize profits is driven by pressure from shareholders and their demands for high dividends;
✓ the inadequacy of accounting rules and the freedom of choice of accounting policies, methods, and treatments from the many options can create opportunities that can lead to distortion of the content of financial statements.
We can conclude that the managers' motives for using these techniques translate as their desire to maximize material benefits and reduce tax liabilities, as well as to

support and promote the image of the economic entity they manage.

4. Creative accounting techniques

The most commonly used creative accounting techniques are:

- the choice between different accounting methods (inventory valuation methods, depreciation methods, etc.) will influence both the financial position of the entity and its performance;
- the manner in which estimates or forecasts are used; for example, the economic and useful life of fixed assets for the purpose of calculating depreciation is an estimate made by the company. A more pessimistic or optimistic scenario may be chosen, depending on the desired outcome.
- artificial transactions may be used to manipulate the outcome of the economic activity or to present the most attractive financial position;
- the timing of a transaction depends on the interest in conveying a certain image of the economic entity's performance and financial position;
- the manipulation of the information presented in Annexes – the inclusion of less or more information in annexes may affect the decisions of external users.

Example: Creative accounting valuation practices

In the case of inventories and other fungible assets (goods which cannot be substantially distinguished from each other), they are valued and recorded in the accounts using one of the following methods:

- First in - first out method – FIFO
- Weighted average cost method – MPC
- The method of last entry - first exit - LIFO

During periods of rising FIFO and LIFO prices have the following impact:

- FIFO - stocks out of management are valued at minimum values, expenses being reduced which determines the increase of the result and implicitly of the profit tax
- LIFO - leads to increased expenses and therefore to a decrease in the accounting result and the final balance of the inventory account.

5. Mitigating creative accounting

In order to stop the harmful effects of creative accounting techniques, it is necessary to establish and implement measures to eliminate their underlying causes.

Based on the ideas presented above, we can argue that, although innovative, creative accounting presents major risks due to its very position on the borderline between legality and illegality, and that the "dividing line" between the two areas is extremely fragile and fluid.

The adoption and usage of creative accounting methods and techniques in bad faith, with the premeditated aim of distorting reality, inevitably leads to situations with disastrous effects on both the economic entity and on the business environment.

The use of creative accounting techniques to alter the image of the business could be limited by the development or elaboration of detailed accounting rules that leave no room for interpretation. Nevertheless, due to the vast diversity of economic activities, it is almost impossible to create a sufficiently rigorous framework for every entity, or for every situation that a business would face, and no matter how many rules are implemented, ways would still be found to "trick" the system.

Although the Romanian legislation includes no express provisions on the identification and sanctioning of the use of illegal creative accounting techniques, we believe that it is necessary to promote precise standards at least at the level of professional associations in order to find solutions to manage the negative effects generated by the perverse application of the concept of creative accounting, which could discourage the use of creative accounting practices that can lead to the decriminalization of the accounting

profession, affecting the economic and competitive environment.

It is also necessary to increase the role of audit bodies in terms of informing, preventing, and developing constructive solutions to the various irregularities found during audits, proposing more simplified and clearer legislative measures that do not leave room for so many interpretations and that concretely assist entities.

6. Conclusions

Creative accounting is not done in bad faith; it complies with the law and accounting rules, but it uses interpretable elements and existing accounting options to mislead the users of financial statements: investors, business partners and the government, making it difficult, if not impossible, to assess the real situation of the company. However, the boundary between creative accounting and fraud is quite fragile, as both are intended to deceive. Although often blamed, creativity in the field of accounting identifies solutions for many problems and generates innovative ideas.

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