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Edited by:

Assoc.Prof. GrațIELA Dana BOCA, PhD

Prof. Cezar TOADER, PhD

***DEPARTMENT OF ECONOMICS
TECHNICAL UNIVERSITY OF CLUJ-NAPOCA, ROMANIA***

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**INFLUENCING THE PERFORMANCE AND FINANCIAL POSITION
AS REPORTED IN THE ANNUAL FINANCIAL STATEMENTS
USING CREATIVE METHODS**

Daniela GEORGESCU
West University of Timisoara, Romania, dn_dmtr@yahoo.com

Dorel MATEȘ
West University of Timisoara, Romania, mates.doloro60@yahoo.com

ABSTRACT

The accounting is a technique designed to collecting, processing, and interpreting the information about the economic flows. Being in the service of the users, accounting has to be neutral to respond objectively to all the parts interested in its functioning and the society's results. In an international principle, the balance sheet is the summary document which presents the financial statement and its evolution. It permits the formulation of value judgments regarding the efficiency and the risks afferent to an enterprise, as well as the assessment of future cash movements. The economic theory considers that the goal of the societies is maximization of profit. However, there are enterprises which aim to realize an acceptable profit using different accounting methods. The creative accounting is an exciting problem, which requires a vigorous solution. The normalization process has a huge influence on the development of the creative accounting as it is characterized by a multitude of options and references. As a result, the accounting harmonization becomes an important base for limiting the phenomenon of creative accounting. The role of the setters and accounting professionals is not simple, as it will be showed in the present article.

KEYWORDS: *Financial statements; Creative accounting; Balance sheet.*

JEL CLASSIFICATION: *F3, M4*

1. INTRODUCTION

In an international principle, the balance sheet is the summary document which presents the financial statement and its evolution. It permits the formulation of value judgments regarding the efficiency and the risks afferent to an enterprise, as well as the assessment of future cash movements.

As a consequence, the enterprises are tempted to aim at improving the balance sheet format and adjusting the profit and loss account. The latter investigates all the operations that contributed to the final result, either the profit or the loss.

The economic theory considers that the goal of the societies is maximization of profit. However, there are enterprises which aim to realize an acceptable profit. The accounting methods permit to the businesses to present, in some limits, results that are consistent with their objectives rather than with reality.

2. CREATIVE METHODS OF MODELING THE FINANCIAL PERFORMANCE

Some of these methods, called accounting policies, occur from selecting between different accounting methods. They aim at straightening the current and net result or at transforming the structure of the result without changing the net one. Other methods, called management decisions, do not express a simple action of accounting records. They register operations, realized by the enterprises, which have as a consequence the optimization of the current and net result. One of the creative methods of manipulating the financial performance is linked to the usage of accounting policies. These procedures contain the possibilities of the managers regarding the accounting arguments. They refer to:

- Clarifying the capacity and level of aggregation of the information published in the summary documents, generally, and in the annexes, especially;
- Establishing the information published in the management report;
- Setting the period of making the financial information known;
- Editing, of oneself, some optional synthesis papers;
- Removing certain accounting principles.

The objectives of the accounting policies differ from one society to another. So, a society that appeals to the public saving, gives importance to the financial consequences of the decisions, while a small or medium organization often favors the tax optimization. As a result, the accounting policies could aim at:

- diminishing the published losses;
- reducing the taxable benefits;
- increasing or decreasing the current result;
- growing or declining the distributions;
- temporary easing the accounting results to reduce the risk remarked by the financial environment.

The management decisions have as a main finality presenting a different image of the result, although, in essence, they do not modify the situation of the society. So, the accounting result represents a very elastic concept. Its elasticity is linked to the time and space dimensions.

Through time, the elasticity comes from the reasoning present/ future. Also, it derives from emphasizing the potential in using the ideas in order to specialize the exercises and connections between the expenses and incomes.

- a. Linking the current expenses to cashing in perspective. The production in progress, the long-term contracts, and the capitalized expenses create difficulties in the inventory evaluation. Moreover, they bring forward the problem of existence of future income streams and the recovery period of the capitalized expenses.
- b. Binding the expenditures in perspective to the current collections. The principle of prudence obliges the managers to identify the facts generating future expenses which have their origin in the actual exercise, and to constitute provisions. However, the latter could have different effects on the results.
- c. Including the future incomes in the result of the exercise. The best-known examples of realizing latent profits to bring the result of the exercise to the desired level are the sales followed by redemption and the sales of old buildings.

Regarding the elasticity in space, it clears from transactions “half true, half false” and from the classification of operations. It can be observed that the classical techniques of straightening are rounded, more and more, by a real administration of the result. Although this administration is based on the action over some accounting principles, some authors consider that there are no

“background incomparability’s between the fundamental accounting principles and the creative accounting, if the latter is used discerning, in a field of application clearly delimited, and in the conditions that respect the spirit in which this notion appeared.”

The depreciation policy influences the evolution of the result. The parameters through which the influence is exercised, are the period and method of amortization. Theoretically, in the virtue of the methods’ consistency principle, the societies can influence the result through the amortization policy but only in the year in which an investment is made. Another policy with impact over the result refers to the provision. The provisions are designated to the coatings risks, expenses or losses whose object is determined precisely, but whose realization and size are uncertain. Requiring assessments, the provisions describe conditions for polishing the results. So, increasing the provisions in the strong years, diminishes the effect, while reducing the provisions in the poor years, improves the result.

Another case targets the small and medium enterprises which are characterized by a reduced number of employees. Most of the times, the owner-manager is the only employee. The situation seems to advantage the manager, because the lack of wage costs influences, upwards, the accounting result and, implicit, the size of dividends.

3. MODELING THE FINANCIAL PERFORMANCE – CREATIVE METHODS

Most of the methods of grooming the performance can be seen at the level of big companies, listed on stock exchange. The motives of the managers to manipulate the accounts can be diverse:

- Smoothing the incomes. Generally, the companies prefer to report a constant tendency of growth of the profit, than to show volatile earnings, marked by a series of dramatic increases and decreases. It can be obtained by constituting big reserves in the good years, so that the provisions would be reduced in the poor years, improving the profits of the companies.
- Manipulating the profit to correspond to the forecasts, which is a version of smoothing the incomes.
- The managers can apply the accounting policy to increase the income, in order to distract the attention from the unwanted news regarding the company.
- The creative accounting can maintain or improve the price of the actions.
- The managers can use the creative accounting to delay the distribution of the information to the market, having the opportunity to benefit by internal knowing.

Another ensemble of reasons for the enforcement of creative accounting in the distortion of performance appears due to the fact that the enterprises are the cause of the diverse forms of contractual rights, obligations, and constraints based on the reported amounts in the financial statements.

At an international level, in some industrial sectors, such as electricity and telephony, the utility companies are under the authority of a governmental organism which establishes the maximum amounts that can be spent. If these companies report big profits, then the organism will proceed to decrease the prices. So, the companies are interested in choosing the accounting methods that seem to reduce their reported profits.

Also, the plan of awards for the manager can be restrained by the level of profit or the price of a share of the company. If it is linked to the price of a share, then it is clear that the managers will be justified to make known the financial statements that will impress the stock market. If

the bonuses are connected to the level of reported profit, then the plan provides that the award is a percent of the profit over a minimum level, and it is paid up to a maximum level.

- If the profit is located between the two limits, the managers will put into practice the accounting methods that will conduct the profit to the maximum limit.
- If the profit is located under the minimum limit, the managers will use the accounting methods that will maximize the provisions so that, in the next years, the reserves would be considered incomes and improve the profit.
- If the profit is located over the maximum limit, the managers will aim to diminish the profit to the limit so that, in the next years, the profit would be increased.

In the developing countries, but not only, the fiscality is, also, a condition in the creative accounting, in the situations in which the taxable profit is assessed based on the accounting numbers.

The management's modification of the big companies entails the motivation of the new management team to constitute provisions that ensure that any loss appears as a responsibility of the previous leadership.

The techniques above target the modeling of the profit and loss account, but they also action over some elements, such as the equity, duty, need for working capital, treasury, and financial position. In the virtue of the prudence principle, the assets must be valued at the historical cost. The strict enforcement of the historical cost principle can affect though the image of the financial situation of a society. So, in some countries, the accounting standard setters authorize, in certain conditions, the reevaluation of tangible assets. Using a series of financial fittings, the enterprises can transform some debts in equities. The idea consists of the issue of titles which present the particularity that is redeemable only at the time of the society's liquidation. The particularity makes them assimilable to the equities.

As a result, on the balance sheet, there is a transfer of the less liquid assets (stocks) to the assets with high liquidity (claims). Regarding the debts that could result from returning the goods, these are not presented in the balance sheet, but will be, in the best case, the object of registration in the order and record accounts.

To obtain funding sources, the enterprises can action on the sales of stocks. The universality of operating consists of the fact that in the sale contract there is an option of stocks redemption. Between the date of the sale and the one of the redemption, the selling society uses the result obtained from the trade as a funding source.

All these operations do not present legal irregularities. The problems appear only in connection with their accounting translation, which reveals that, in the last years, the international accounting, generally, and the Romanian one, particularly, lost a part of its attitude to replicate the sirens of the commercial city. If it does not want to lose its soul forever, it has to retain those criteria that allow it to find a fair balance between the civic city and the commercial one. The ball is, therefore, in the field of the accounting professionals.

So, the president of the Institute of Chartered Accountants in England and Wales (ICAEW) drew attention to "the serious problems of window dressing the balance sheet and off-balance sheet financing."

A year later, ICAEW (<http://www.icaew.com/en/library>) issued a technical norm which targeted the creative accounting. According to the norm, the choice of the suitable accounting treatment of an operation is based on its economic substance. However, there should be mentioned that, for portraying an accurate image of the enterprise's financial statements, is necessary the provision of information regarding the legal form of the transaction.

Moreover, the creative accounting concerned the accounting profession and the normalizing court of the United States of America. So, Bullen affirmed that “limiting the creative accounting is one of the most complex projects of the normalizing American body.”

Also, Warfield, T., Wild, J. and Wild, K. (1995) drew attention to the fact that, because the creative accounting can deceive the users of financial information, its usage raises questions over the objectives of the summary documents.

4. THE FIGUREHT AGAINST THE CREATIVE ACCOUNTING

The accounting is a technique designed to collecting, processing, and interpreting the information about the economic flows. Being in the service of the users, accounting has to be neutral to respond objectively to all the parts interested in its functioning and the society's results. Here are some ways through which the external users of financial information could avoid the traps of the creative accounting. There has to be viewed the annual report through well-established filters, which facilitate the checking on a longer period of time. Using the cash flow information at the expense of those that show the result is recommended to avoid creativity. It is known the fact that the accounting techniques accept the arrangement of the accounting result, but do not generate liquidities. The availabilities are more important than the profits because their insufficiency can determine the collapse of the business.

5. CONCLUSION

So, the creative accounting is an exciting problem, which requires a vigorous solution. It is obvious that the normalization process has a huge influence on the development of the creative accounting as it is characterized by a multitude of options and references. As a result, the accounting harmonization becomes an important base for limiting the phenomenon of creative accounting. It has to be highlighted, though, the fact that the efforts towards the international accounting harmonization are heading, at least for now, on the multinational societies. It appears that, as long as many explanation's systems coexist, it is indispensable that the societies specify the system that they used to compose the summary documents.

The international accounting practice proves that every time when a new direction is born, the enterprises find a way to diminish their impact. According to these facts, Devis affirmed that no matter how many rules would implement the profession, there would always be some who would find a way to “beat” the system. In conclusion, the role of the setters and accounting professionals is not simple, as imagination must be answered with imagination.

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