



Another image of accounting – creative accounting

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Abstract

Creative accounting emerged during the last century in the English-Saxon economies as a result of the growing complexity of the economic reality. Creative accounting can be defined as the set of techniques used by a company's accounting unit to modify the presentation of its accounts in a manner favourable to its expectations. Creativity in accounting can be used depending on the intention of the accountant, both in order to manipulate the financial statements and to find new solutions and accounting methods to the problems faced by a company. The positive or negative side of creative accounting is given by the many motivations for using it. The objective of this research is to present the main techniques and principles of creative accounting and its applicability at the national level in order to identify the advantages or limitations of using this new 'creative accounting' paradigm. The research methodology used in this scientific article is based on the study of the specialised literature in the field using theoretical documentation and comparative analysis.

Keywords: Creative accounting techniques, Principles, Reports.

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1. Introduction

Over time, creativity has made its presence felt in all areas and has inevitably led to the development and progress of human society. In accounting, creativity refers to the practices by which professional accountants use their knowledge and skills to ‘cosmetology’ the image of the financial position and economic and financial performances of an enterprise (Nicoleta-Cornelia, Sorina-Geanina, Mihaela & Rodica 2012, p. 531). This cosmetology is done by manipulating and arranging the figures so that the items presented in the financial statements are distorted and adjusted to satisfy the different categories of users of accounting information.

Creative accounting emerged during the last century in the Anglo-Saxon economies as a result of the growing complexity of the economic reality. The concept of creative accounting first appeared in the specialty literature in 1976, when British researcher J. Argenti showed that there is a direct link between creative accounting practices and techniques and the business regression driven by incompetent managers, while pointing out that the use of creative accounting is a sign of crisis (Argenti, 1976, p. 12).

K. Naser, in his book ‘Creative Financial Accounting: Its Nature and Use’, has placed creative accounting somewhere in the early part of the last century, stating that ‘account manipulation is an old accounting problem starting in the 1920s’ (Naser, 1993, p. 59).

The existence of numerous recent studies on creative accounting shows the interest of specialists in the field for the use and development of creative accounting techniques and practices.

2. Creative accounting – concept, relevance and impact

The specialised literature has over time provided several definitions of creative accounting. One of the most comprehensive and complex definition was given by K. Naser in ‘Creative financial accounting: its nature and use’. It defines creative accounting as:

1. the process by which, given the existence of breaches in the rules, the accounting figures are manipulated, and taking advantage of flexibility, those measurement and information practices are chosen, which allow the transformation of the synthesis documents from what they must be to what managers want; and
2. the process through which transactions are structured in such a way as to enable the ‘production’ of the desired accounting result (Naser, 1993, p. 59).

The concept of creative accounting was also defined by M. Jameson who, from a practitioner’s perspective, has determined that the accounting process involves operating with different opinions and resolving conflicts between them in order to present the results generated by transactions. Such flexibility facilitates manipulation, deception and distortion. These activities, practiced by some less scrupulous members of the profession, are becoming known as creative accounting (Jameson, 1988, p. 7).

At the same time, Jameson stressed that there is no doubt about the negative nature of creative accounting. It distorts the results and the position regarding the enterprise, and if we give them theorists’ belief, it becomes an increasingly used practice (Jameson, 1988, p. 20).

Another author, M. Trotman, has defined creative accounting as a communication technique aimed at improving the information provided to investors.

In the article ‘Policies and accounting options (Fair Accounting versus Bad Accounting)’, N. Feleaga stated: ‘the concept of creative accounting is usually used to describe the process by which professional accountants use their knowledge to manipulate the figures included in the accounts year’ (Feleaga & Malciu, 2002, p. 390).

Based on these definitions, the following conclusion can be drawn: creative accounting is the result of accounting ‘spinning’, indicating that information practices and communication techniques are often at the limit of law and lawlessness, where accounting information is somewhat concealed, embellished and adjusted by professionals (accountants, financial auditors, tax consultants, etc.) so as to better meet the interests of their users.

The approach to this new image of accounting, by identifying the concept and practices of creative accounting, may have as a point of interest the need for knowledge of the human society in continuous economic development.

Based on J. Argenti’s view that recourses to creative accounting techniques and practices is a predominant sign of crisis, we believe it is important to present in an objective manner the importance and impact of creative accounting in an uncertain economic environment and challenges.

Being a topical subject, creative accounting has attracted the attention and concern of many researchers, as evidenced by the abundance of specialised literature with reference to this topic of interest. However, there has not yet been a common point agreed by both researchers and practitioners on the usefulness of creative accounting.

Although there have been and still are opinions for and against adopting creative accounting practices, most authors who have studied this new accounting side have agreed that by resorting to creative accounting practices, there is no violation of legal regulations; professional accountants must demonstrate creativity to provide solutions to those interested by exploiting legal boundaries and breaches; creative accounting techniques have the effect of balancing the economic reality to the limit of credibility in order to serve interests.

By studying the ideas found in the literature, one can conclude that most practitioners condemn the use of these practices that result in the manipulation and distortion of accounting information. For them, creative accounting is ‘bad accounting,’ the negative character of which is highlighted by words and expressions such as ‘manipulation of figures’, ‘accounting spins,’ etc.

But there are also some authors who see creative accounting as a positive thing. H. Stalowky notes the following: ‘The accounting options have always been at the disposal of the accountant, and they do not imply creativity in the strict negative sense of the word’ (Stalowky, 2000, p. 157). The French author concluded that the use of creative accounting practices is to find a solution to problems that do not find it in existing accounting rules at a time. The authors J.L. Malo and H. Giot, cited by Manciu and Cotlet, said creative accounting was virtuous: ‘it provides accounting for ways to keep up with growing markets and the proliferation of financial products’ (Manciu & Cotlet, 2012). But the same authors also talked about the possibility of transforming positive creative accounting into a negative one, namely the rapid manifestation of the instinctive perversity of businessmen, who in their turn for profit can generate abuses.

Positive views on creative accounting show that without the innovations of professional accountants, reforms in the field of accounting would not have been possible. With the help of creativity, solutions to accounting problems have been discovered that have not been provided for in standards, so it can be concluded that as long as professional accountants act in good faith, creative accounting can fulfil its purpose of finding better solutions to problems faced by the entity management. The negative character of accounting innovation, according to the literature, results from the fact that only some of the users of accounting information have the advantage of presenting the accounting data in a certain way, wherein the private interest of some consumers of accounting information prevails over the interest of others and the public interest.

3. Principles and techniques of creative accounting

The phenomenon of globalisation, as well as the complexity of economic reality, has increased the importance of information in substantiating decisions. Creative accounting has emerged precisely in response to the increasingly complex demands of economic life.

The emergence of difficulties in the credibility and importance of information provided by the financial statements has been a defining premise for generating imaginative accounting practices. The choice of alternative treatments and accounting policies when transactions are made represents creative accounting techniques. The pressure exerted by investors and managers, the financial interests and, why not, the desire to defeat the system are just a few motivational factors that make innovation in accounting attractive (Comandaru (Andrei), Stanescu & Paduraru, 2018, p. 124).

A classification of innovative accounting practices was proposed by A. Grosanu in the article 'Creative Accounting', and it follows the main structures of the balance sheet and considers the following four categories:

1. Creative accounting techniques on fixed assets;
2. Creative accounting techniques on current assets;
3. Creative accounting techniques on equity and liabilities;
4. Other creative accounting techniques (Grosanu, 2013, p. 38).

In 2002, Mulford and Comiskey proposed another classification, namely five categories of creative accounting practices used in making financial statements, which are as follows:

1. Recognition of premature or fictitious income;
2. Aggressive capitalisation policies and use of extended depreciation periods;
3. Misstatement of assets and liabilities;
4. Creativity in the income statement;
5. Cash flow reporting issues (Mulford & Comiskey, 2002, p. 9).

By analysing the two classifications, one can note that the most commonly used creative accounting practices (Figure 1).

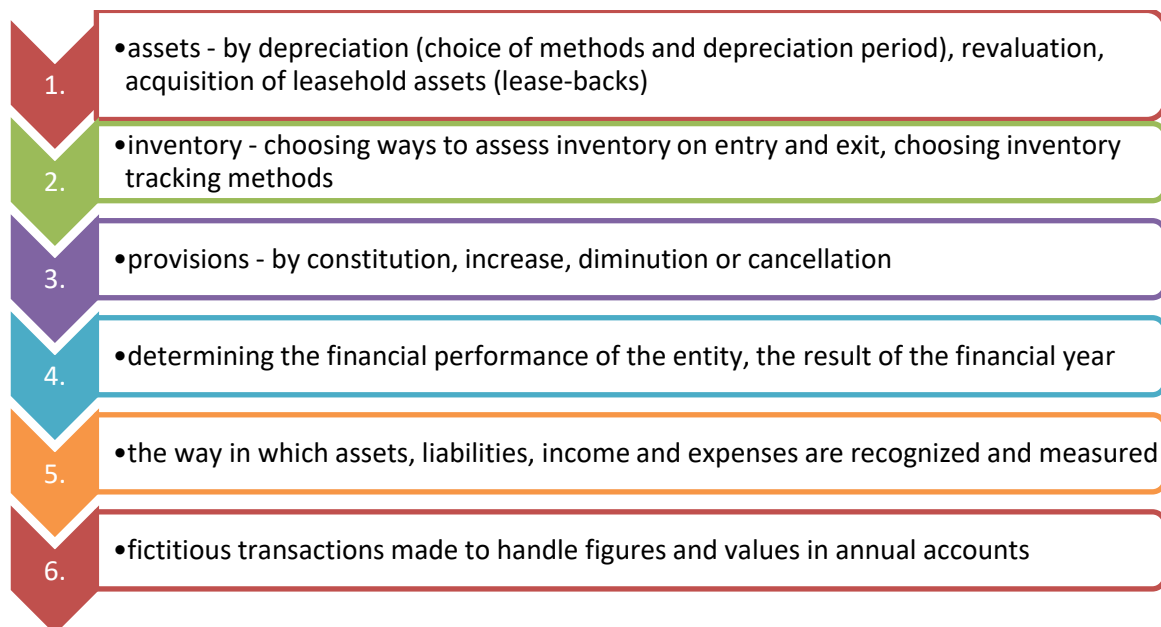


Figure 1. Creative accounting practices. Source: Created by the authors

The practices and techniques used by creative accounting are multiple, and their classification differs according to the criteria that each author has set. From analysing the literature, we note that each typology has its limits. However, specialists have concluded that tools used in creative accounting – based on accounting choices and professional judgment – have an impact on the financial statements, the financial position and the entity's performance.

4. Case study 'Influence of the fixed assets depreciation policy on the performance of a Romanian entity – comparative analysis'

The International Accounting Standard (IAS) 16 defines fixed assets as tangible items that:

- a) are held for use in the production or supply of goods or services, to be leased to third parties or to be used for administrative purposes;
- and
- b) it is expected to be used over several periods.

The definition in the international reference was also taken over by the accounting regulations in Romania and was approved by the Order of the Minister of Public Finance no. 1802/2014.

One of the most important issues related to the accounting of fixed assets is depreciation. Depreciation is systematic allocation of the depreciable amount of an asset over its useful life [International Accounting Standard no. 16]. In other words, the purpose of depreciating an asset is to recover its value in the entity. It is a way of matching the cost of a fixed asset with the revenue (or other economic benefits) it generates over its useful life (<http://accounting-simplified.com/financial/fixed-assets/depreciation-methods/>).

The accounting treatment of depreciation is a technique of creative accounting because it influences the evolution of the result through:

- the depreciation method; and
- the depreciation period.

The accounting regulations regarding the individual annual financial statements and the consolidated annual financial statements approved by the OMFP no. 1802/2014 recognise three depreciation methods: the straight line method, the diminishing balance method and the accelerated method.

Choosing any depreciation method to the detriment of another has a different impact on the company's current result. Depending on the depreciation expense allocation over the useful life of the asset, the influence of the depreciation method on the entity's performance is as follows:

- a) the straight line method – expenditures with constant depreciation during the useful life of the asset;
- b) the diminishing balance method – results in a decreasing expense with the depreciation over the useful life of the asset;
- c) the accelerated method – leads to higher expenditures in the first year, with the effect of decreasing the result and uniform expenses for the rest of the remaining period (Munteanu & Zuca, 2011, p. 8).

The depreciation period (the useful life of the asset) is a concept that has different synonyms depending on the nature of regulations; so if we talk about accounting rules, we talk about economic use period; in the case of tax rules, we talk about the normal use period. OMFP no. 1802/2014, article 139, par. (3) defines the depreciation period as the useful life that represents: 'the period during which an asset is expected to be available for use by an entity'.

The Romanian tax rules recognise the depreciation period as set out in the Catalogue on Classification and Normal Operating Functions of Fixed Assets; the depreciation periods are related to

the straight line depreciation regime being expressed in years. But the depreciation period should be set by the enterprise according to the actual conditions in which it operates.

At 31.12.Y-1, we know the following data from the Income Statement of ALPHA Ltd.

Table 1. Income statement of Alpha Ltd. — main indicators

Items	Value (euro)
Sales	520,000
Other income	15,000
Total income	535,000
Cost of sales	305,000
Salaries and wages expense	138,000
Depreciation expenses	0
Other expenses	5,000
Total expense	448,000
Profit before tax (loss)	87,000

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At 01.01.Y, ALPHA Ltd. purchased a machine costing 180,000 euros + VAT.

5. Results

Scenario I: Impact of the depreciation method chosen on the entity's result (profit before tax/loss):

Regarding the depreciation policy of the machine we know the following:

Variant A — the straight line method

Variant B — the diminishing balance method

Variant C — the accelerated method

In all three variants, the depreciation period (the useful life of the machine) is 5 years.

Table 2. Income statement of Alpha Ltd. — the impact of the straight line method on the entity's result

Variant A (the straight-line method)	Year 1-euro-	Year 2-euro-	Year 3-euro-	Year 4-euro-	Year 5-euro-	Total-euro-
Sales	520,000	520,000	520,000	520,000	520,000	2,600,000
Other income	15,000	15,000	15,000	15,000	15,000	75,000
Total income	535,000	535,000	535,000	535,000	535,000	2,675,000
Cost of sales	305,000	305,000	305,000	305,000	305,000	1,525,000
Salaries and wages expense	138,000	138,000	138,000	138,000	138,000	690,000
Depreciation expenses	36,000	36,000	36,000	36,000	36,000	180,000
Other expenses	5,000	5,000	5,000	5,000	5,000	25,000
Total expense	484,000	484,000	484,000	484,000	484,000	2,420,000
Profit before tax (loss)	51,000	51,000	51,000	51,000	51,000	255,000

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Table 3. Income statement of Alpha Ltd. — the impact of the diminishing balance method on the entity's result

Variant B (the diminishing balance method)	Year 1- euro-	Year 2- euro-	Year 3- euro-	Year 4- euro-	Year 5- euro-	Total- euro-
Sales	520,000	520,000	520,000	520,000	520,000	2,600,000
Other income	15,000	15,000	15,000	15,000	15,000	75,000
Total income	535,000	535,000	535,000	535,000	535,000	2,675,000
Cost of sales	305,000	305,000	305,000	305,000	305,000	1,525,000
Salaries and wages expense	138,000	138,000	138,000	138,000	138,000	690,000
Depreciation expenses	54,000	37,800	29,400	29,400	29,400	180,000
Other expenses	5,000	5,000	5,000	5,000	5,000	25,000
Total expense	502,000	485,800	477,400	477,400	477,400	2,420,000
Profit before tax (loss)	33,000	49,200	57,600	57,600	57,600	255,000

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Table 4. Income statement of Alpha Ltd. — the impact of the accelerated method on the entity's result

Variant C (the accelerated method)	Year 1- euro-	Year 2- euro-	Year 3- euro-	Year 4- euro-	Year 5- euro-	Total- euro-
Sales	520,000	520,000	520,000	520,000	520,000	2,600,000
Other income	15,000	15,000	15,000	15,000	15,000	75,000
Total income	535,000	535,000	535,000	535,000	535,000	2,675,000
Cost of sales	305,000	305,000	305,000	305,000	305,000	1,525,000
Salaries and wages expense	138,000	138,000	138,000	138,000	138,000	690,000
Depreciation expenses	90,000	22,500	22,500	22,500	22,500	180,000
Other expenses	5,000	5,000	5,000	5,000	5,000	25,000
Total expense	538,000	470,500	470,500	470,500	470,500	2,420,000
Profit before tax (loss)	(3,000)	64,500	64,500	64,500	64,500	255,000

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Scenario II: Impact of the depreciation period chosen on the entity's result (profit before tax/loss):

☒ Variant A: The economic use period (accounting rules) = 5 years

☒ Variant B: The normal use period (tax rules) = 4 years

Table 5. Income statement of Alpha Ltd. — the impact of the economic period on the entity's result

Variant A (the economic use period = 5 years)	Year 1- euro-	Year 2- euro-	Year 3- euro-	Year 4- euro-	Year 5- euro-	Total- euro-
Sales	520,000	520,000	520,000	520,000	520,000	2,600,000
Other income	15,000	15,000	15,000	15,000	15,000	75,000
Total income	535,000	535,000	535,000	535,000	535,000	2,675,000
Cost of sales	305,000	305,000	305,000	305,000	305,000	1,525,000
Salaries and wages expense	138,000	138,000	138,000	138,000	138,000	690,000
Depreciation expenses	36,000	36,000	36,000	36,000	36,000	180,000
Other expenses	5,000	5,000	5,000	5,000	5,000	25,000
Total expense	484,000	484,000	484,000	484,000	484,000	2,420,000
Profit before tax (loss)	51,000	51,000	51,000	51,000	51,000	255,000

Created by the authors.

Table 6. Income statement of Alpha Ltd. — the impact of the normal use period on the entity's result

Variant B (the normal use period = 4 years)	Year 1-euro-	Year 2-euro-	Year 3-euro-	Year 4-euro-	Year 5-euro-	Total-euro-
Sales	520,000	520,000	520,000	520,000	520,000	2,600,000
Other income	15,000	15,000	15,000	15,000	15,000	75,000
Total income	535,000	535,000	535,000	535,000	535,000	2,675,000
Cost of sales	305,000	305,000	305,000	305,000	305,000	1,525,000
Salaries and wages expense	138,000	138,000	138,000	138,000	138,000	690,000
Depreciation expenses	45,000	45,000	45,000	45,000	0	180,000
Other expenses	5,000	5,000	5,000	5,000	5,000	25,000
Total expense	493,000	493,000	493,000	493,000	448,000	2,420,000
Profit before tax (loss)	42,000	42,000	42,000	42,000	87,000	255,000

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6. Discussion

In Romania, the motivation of professional accountants to use creative accounting techniques is supported by the determination of the company's result: a result that can be seen from two perspectives, namely linking Romanian accounting to the tax system – the size of the accounting result is very important in determining the profit tax; a great profit will result in an increase in corporate income tax, and this has always been a challenge for local accountants who have tried to avoid some tax regulations; determining the value of an enterprise is also made on the basis of the accounting result, which again is given special attention at the expense of other indicators, which, in our opinion, are more suggestive in the evaluation of an entity: sales, revenue, net assets etc.

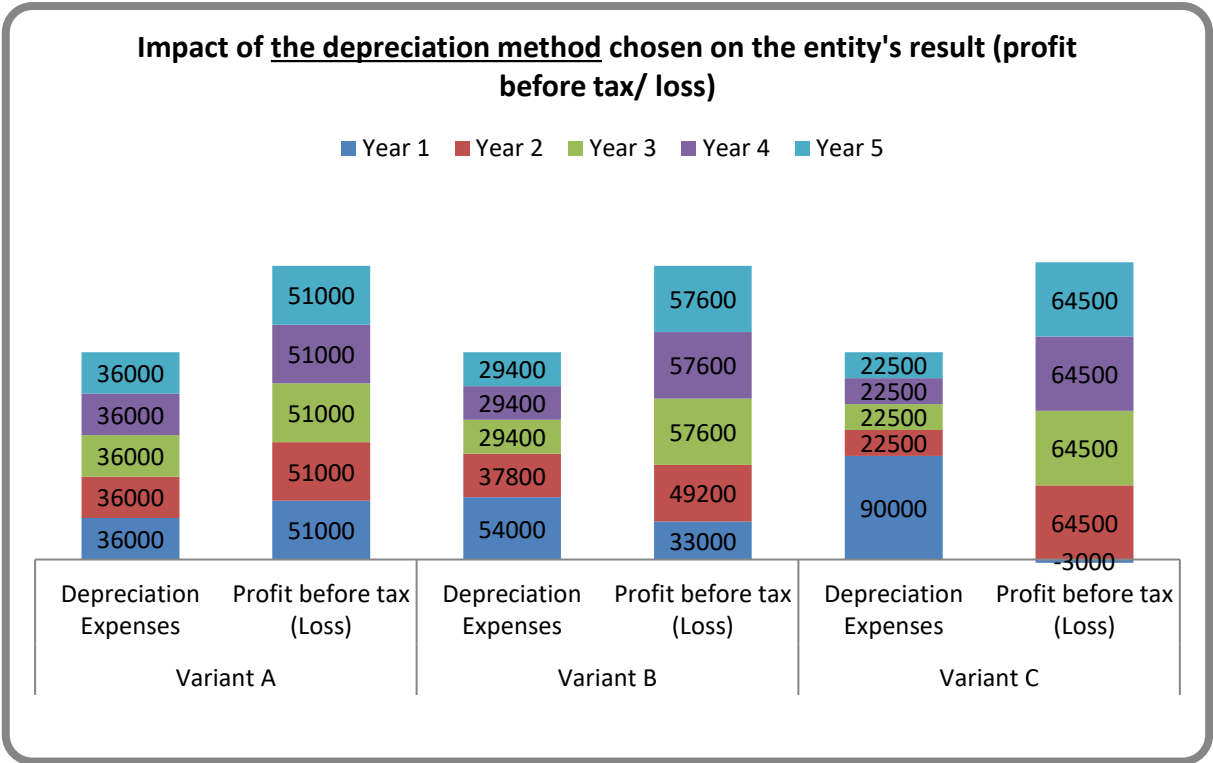
The main objective of the case study proposed above was to analyse how the depreciation policy chosen by the enterprise influences its performance. Choosing a depreciation method to the detriment of the other, namely choosing the depreciation period according to the concrete conditions in which the company's business is carried out is a practice in which it uses creative accounting. The accounting rules in force at both national and international levels offer alternative treatments in terms of company depreciation policy and this gives entities the opportunity to cosmetise their outcome.

The aspects under analysis (depreciation method, depreciation period) in order to achieve the proposed objective are highlighted by the following conclusions:

Scenario I: Impact of the depreciation method chosen on the entity's result (profit before tax/loss):

- ✍ given the specificity of Romanian accounting connected to taxation, the company's depreciation policy is usually chosen according to the tax rules in force; so distinct notions of accounting depreciation and tax depreciation are merged into practice;
- ✍ as it is deducted from the calculation of taxable profit, tax depreciation is desirable to be higher than the accounting one, this implies lower tax on profit and a higher accounting result;
- ✍ the company's depreciation policy should be chosen according to its strategy: a company that wants to obtain a higher profit calls for a straight line depreciation, on the other hand, to reduce the result, it calls for an accelerated depreciation;
- ✍ the accelerated depreciation method is not approved by the authorities because the deduction of a 50% expense from the depreciation of the machine in the first year reduces the tax result and the tax due. On the other hand, the accelerated method offers an advantage to the enterprise, especially in the first year, if it wants to reduce its tax burden, but if it wants to get an accounting result which satisfies investors, the expense with the amortisation in the first year becomes a disadvantage;

- ✍ in the case of accelerated depreciation, the result obtained by the entity in the first year is notably diminished by the depreciation expense and in the coming years the result before tax will be constant;
- ✍ the diminishing balance method gives the impression of obtaining a result that improves over time; in comparison, the straight line depreciation method highlights a constant result of the entity.



**Figure 2. Impact of the depreciation method chosen on the entity's result (profit before tax/loss).
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Scenario II: Impact of the depreciation period chosen on the entity's result (profit before tax/loss):

- ✍ when the entity chooses short depreciation times, the result before tax is diminished with a higher depreciation expense, with the entity's performance improved at the end of the depreciation period;
- ✍ on the other hand, when the entity chooses longer depreciation times, there are more profitable annual results, as annual depreciation costs are lower;
- ✍ returning to the connection of accounting to the tax system, we can conclude that a useful life longer than the legal use period brings only disadvantages for the entity: the accounting result decreases in a smaller proportion, but over several years and the last years in which the depreciation expense is zero, there is a burden for the enterprise, with its performance being low and the high fiscal pressure.

The depreciation policy can influence the result of the enterprise by manipulating the users' decisions of the information presented in the financial statements. The use of creative accounting practices in the field of fixed assets depreciation has economic and fiscal implications. Any of the above options may offer the entity benefits based on the strategy chosen. As a rule, an immobilised asset can influence the result by amortisation only in the year in which it enters into management,

and then puts into operation the principle of the permanence of the methods. But legislation provides a loophole and an incentive for creative accounting; changing the depreciation policy over the life of the asset.

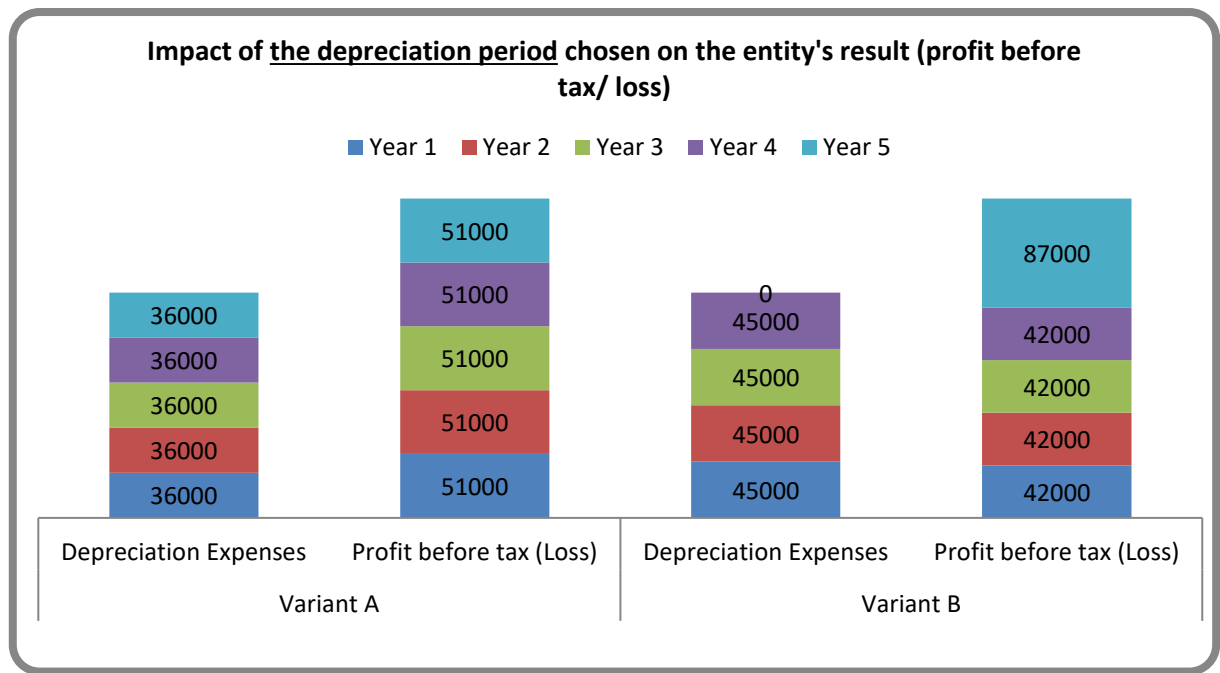


Figure 3. Impact of the depreciation period chosen on the entity's result (profit before tax/loss).
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The overall conclusion of the case study is that regardless of the chosen depreciation method and the depreciation period set, in fact, *the performance of the enterprise is the same*, the impact of the use of creative accounting techniques in the case of depreciation is psychological: the advantages obtained during of the depreciation time disappears at the end of the period when the depreciation effect stops on the entity's result.

7. Conclusion

Creative accounting is the result of accounting ‘spinning’, indicating that information practices and communication techniques are often at the limit of law and lawlessness, where accounting information is somewhat concealed, beautified and adjusted by professionals in the field (accountants, financial auditors, tax consultants, etc.) so as to satisfy the interests of their users.

In the literature, the opinions of researchers are divided between the negative and the positive nature of creative accounting.

The negative nature of creative accounting is exemplified in countless ways: from manipulating accounts to misleading certain users of accounting information into major economic scandals, to the fact that the use of accounting engineers is a precursor to the immorality of the professional accountants practicing it.

On the other hand, the positive character of creative accounting is supported only by the fact that it helps the progress of human society (economic, legal and social evolutions).

Creative accounting has an significant importance in the development of national and international accounting rules, precisely because the impact of creative accounting techniques and practices is

negative and new accounting rules must be created to prevent the manipulation of financial information transmitted to users.

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