

# Creative Accounting and the Impact on the Financial-Accounting Information Users

Laura-Maria Popescu, Ileana Nişulescu-Ashrafzadeh

**Abstract**— This article aims at presenting an analysis of the Creative Accounting phenomenon, both from the quality as well as from the quantity point of view, and from the manipulation practices they have on the financial-accounting information users. Thus, bi-directionally, we analyzed the research subject, in the light of the works published on the theme of creative accounting, but also by implementing direct research on the companies in Romania. We also analyzed the creativity in Accounting from a positive perspective and from a negative one as well, so we could shape up a clear opinion on the impact these practices have on the message sent to the users, via the information presented in the financial-accounting situations.

**JEL Classification:** M40

**Index Terms**— creative accounting, financial and accounting engineering, performances, accounting information.

## I. INTRODUCTION

Research has as target to detect the modality of perception of the financial-accounting engineering by the people directly involved in the accounting activity of an enterprise, the area of knowing the methods of achieving them and the implications they have on the financial situations.

Taking into consideration that recently, creative accounting is felt evermore in a company's activity, and also as a study subject in the academic and professional environment, a study on the phenomenon among the companies in Romania was required.

Another objective of the study is to see the reaction of the interviewed subjects in relation to the theme of research.

The study is based on a series of hypotheses concerning the level of extension and knowledge of the practices of the type of financial-accounting engineering.

One of the main work hypotheses refers to the modality in which financial engineering is perceived by the people in the business environment. Should action be taken on purpose, the people applying such practices know both the modality in which the company performs its activity, as well as the legislative aspect, in order to fit within the limits imposed by the law, at the same time speculating the existing breaches in the norms.

Another hypothesis the research is based on is that according to which, financial investors are cheated by being presented certain financial situations resulted from manipulation. Keeping in mind that most reasons at the base of financial-accounting engineering have aim at attracting

financing sources, presenting certain elements in a manner meant to influence the decision to invest can be deemed as a form of fraud, of covering up the reality or of presenting it in a modified way.

## I. METHODOLOGY OF RESEARCH

Each research aims at bringing new elements of the attention of the reader, at finding solutions to certain problems or at analyzing key-concepts specific to the field of study. To reach their targets, researchers must use a series of methods and research instruments, as well as various scientific approaches. Throughout any research, knowledge and the choice of the best methods and instruments are important, so that the result should encompass the essence and the element of novelty in the field of study.

As far as the proposed research methodology is concerned, based on bibliographic documentation, we aimed to systematically observe the phenomenon and the determinant causes, followed by the data analysis, synthesis and validation, as well as by a prevision of the phenomenon in the near future. The phenomenon has been studied throughout a long period in Romania, by comparison to the evolution of the phenomenon at international level.

The study combines the quality with the quantity type of research, for a more comprehensive and complex presentation of all the aspects captured by this study.

The data obtained by applying the questionnaire have been analyzed in Excel and the results shaped up in drafting a guide on motivation, detecting and limitation that would allow the regulation authorities and other interested parties to identify and mitigate the impact of creative accounting.

The research took place during June 2013 – June 2018, the subjects being selected from various fields of activity and cities, conferring relevance to the study. Taking into account the fact that the subject of the study represents a delicate theme for most people, both in the business as well as in the professional environment, no direct questions were asked, reason for which confirming or informing certain hypothesis can be done by correlating several answers. The research is based on a representativesample group, the subjects being chosen from various fields of activity, from management ranks or financial-accounting departments, to confer a high level of confidence in the research.

## II. THE STAGE OF KNOWLEDGE

The term of creative accounting is frequently met in the 1970s in the Anglo-Saxon specialty literature, Watts & Zimmerman (1978, 1986, 1990), subsequently being developed in the context of globalization, together with the emergence of the first signs of uncertainty generated by the

**Laura-Maria Popescu**, PhD Student, Bucharest University of Economic Studies, Bucharest, Romania  
**PhD Ileana Nişulescu-Ashrafzadeh**, Univ. Prof. Bucharest University of Economic Studies, Bucharest, Romania

capacity of the economic environment to keep under control the prices that had become unstable on the short-run, and with the correct assessment of what means a good owned by an entity.

In 1976, John Argenti underlined with his study that the use of creative accounting is a factor to generate the economic crisis and decline in the field of business, being based on the incompetence of the managers.

Manipulation notions that would shape up creative accounting elements emerged in the specialty literature and in the articles written by Watts and Zimmerman (1978, 1986, 1990), based on the theory of positive accounting that would put the focus on older research on the subject, initially made in the 1960s, in the studies written by Ball and Brown, Beaver and Jensen.

In the analysis of specialty literature, we can see that the interest in financial-accounting engineering research was born in the 80s, shyly developing by the end of the 90s and the dawn of the new millennium, moment when together with the emergence of the great economic scandals, as well as of the periods of crises, the studies in the field of creative accounting bloated.

The Enron scandal is one of the most popular examples of creative accounting. In 2001, the American corporation Enron declared its bankruptcy following certain fraudulent and deceitful accounting practices, applied throughout the 1990s. The company masked its debts, registered losses and manipulated financial reports to create the illusion of profitability. Arthur Anderson, the auditing company, was accomplice to the deceit by hiding the creative and fraudulent elements discovered in the financial situations, allowing Enron to continue its illegal accounting practices, Arnold & Lange, (2014).

In the context of financial scandals, the problem of financial-accounting engineering is brought under discussion by Baker and Hayes (2004), who relate these financing practices outside the balance sheet, the acknowledgement of income, quality of information found in the financial situations, which imposes their classification into illegal or on-the-edge-of-the-law practices.

### Positive and negative in creative accounting

The concept of creative accounting comes often with a negative connotation. Most of the definitions given by the professionals present creative accounting as mechanism of manipulation of the information presented in financial situations, with the main purpose of misleading the investors or the state authorities. Thus, the financial situations are drafted to meet the desire of the managers with concern to the company's financial position and performance. This implies either using accounting methods that lead to a fictitious growth of profit for an economic entity (to attract new investors) or methods, that on the contrary, favor the display of modest results (on the purpose of paying lower taxes). To shape up the negative side of creative accounting, there are very many concrete cases. Among the most significant examples, the one to stand out is that of poor management, that makes contractual engagements on relatively short terms, time when they hunt rewards received based on the bonus systems, subsequently abandoning the company, leaving it in

an uncertain situation and migrating to another one, on the same purpose. Another example would be the beautification of a company's image to attract investors, aiming at selling it. Basically, the new owners buy a company that in reality is not all that profitable and well positioned as it is shown in the financial situations, thus shaping up the deceitful character of these practices. Similar is the case when the company aims at obtaining credits or financing sources that it could not return according to the expectations of the financiers, potentially generating a series of unbalances.

Except for the opinions that present creative accounting in a negative light, there are also other points of view according to which this is a beneficial technique aiming at finding solutions to the problems recently come up in Romania, with the purpose of presenting as close as possibly the financial position and performance of an entity. It is also known the fact that this creativity of accountants simulates the evolution of accounting, and implicitly, the economic and social progress, Groșanu, Răchișan & Berinde, (2011). In reality, one of the manifestations of creative accounting is professional reasoning, specific to the accounting profession, being necessary when applying norms is not sufficient for a close reflection of reality.

The term "creative" is used to indicate the opposite of the conservative idea in the principles of accounting, gaining negative connotations when associated with this science in the light of breaching onto ethics. Keeping in mind that the creative elements of accounting do not necessarily imply breaching onto legal regulations, we can say that there is also a positive side of it, the difference being made by the manner and purpose of using these practices. Let's take for instance the situation of a company that, in order to be saved from bankruptcy, needs investments or financing, the managers know and are aware of the condition of the company and its ability to recover, but in order to have real chances to obtain funds, the financial situations receive a very subjective treatment. The company obtains the funds based on creative financial situations and thus gets a new chance to continue its activity. Financial-accounting engineering used reasonably and in good faith may have a positive character and may help a company overcome a critical period.

We can also support the existence of positive elements in accounting creativity by the example of certain companies that need to present a favorable situation in order to keep its clients. Let's assume that a company has three major clients, besides the regular ones. For reasons that do not depend on the company, one of the big clients chooses to address another supplier. The moment when the other clients of the company notice a drastic drop of the turnover, they could manifest concern and be tempted to address other competitor companies, considering that the current supplier might decline and thus be not able to continue its contracts under way. To avoid creating such situations, the company management comes in to mitigate the impact generated by the loss of a client, in the financial-accounting situations, and smoothed down the transition, to avoid generating panic among the other clients.

Similar actions can be taken by the management to avoid generating panic among the employees or the interested

third-parties, given that when a boat catches water, it tends to rock, and most people desert it trying to save themselves, without passing through the filter of reason the causes and possibilities to carry through the journey, remaining in the boat. Perhaps the deck was wet due to rain or storm, perhaps the passengers were not evenly distributed, perhaps the situation is under the control of the captain and the idea is only a false perception generated by the rumor spread by a disturbing element.

Countless examples present some of the positive aspects of using creativity in accounting, since it is easier to accept a company with a slight downfall trend, than one presenting a sudden turnover decrease. And since the difference between difficult and drastic is very sensitive in the business environment, any company management finds creative solutions meant not to affect the image and continuity of activity.

III. THE REASEARCH RESULTS

The structure of the questionnaire allowed to a certain extent to draw the portrait of the subjects, to characterize the companies targeted by the study, to identify creative practices, to apply them for the respective entities, as well as to remark the attitude of the people questioned on this topic.

From the analysis of the answers presented, we can see the accounting engineering activities are not seen as deceit, but rather they are understood as a modality to „sell” the image of a company presenting positive aspects.

Table 1 Motivation of the utility of creative accounting practices

Situations when the company could be helped by accounting information manipulation practices		
Versions	Answers	%
in trading relations	31	18.13%
in share transactions	71	41.52%
in obtaining certain financial resources	112	65.50%
in reorganization activities	26	15.20%
others (overcoming a critical period, positioning on the market)	7	4.09%

Source: from the centralization of the answers in the market study developed by the author, making for the object of the research.

In this way, the work hypothesis according to which engineering could be seen as a user’s modality of deceit could not be confirmed. Of course, in this case the answers given are evasive and subjective, from the perspective of the initiator who, appealing to these techniques does not think they effectively deceit, but high lighten the strong points of the business. Neither this approach modality is far from reality, as long as the techniques used do not significantly and fraudulently affect the presentation of financial situations, having to deal here with the reasoning of each accounting professional.

Table2.Knowing and understanding the impact of creative practices on the economic-financial process

Question	Version s	No of answers	Percent age
Do you consider creative practices to be legal?	Yes	109	63.74%
	No	34	19.88%
	I don’t know / I don’t want to answer	28	16.38%
Question	Version s	No of answers	Percent age
Do you consider creative practices to be moral (ethical)?	Yes	21	12.28%
	No	138	80.70%
	I don’t know / I don’t want to answer	12	7.02%
Question	Version s	No of answers	Percent age
Do creative accounting practices affect the presentation of financial-accounting situations?	Very much	66	38,60%
	Much	71	41,52%
	Undeci ded	21	12,28%
	Little	8	4,68%
	Very little	5	2,92%

Source: from the centralization of the answers in the market study developed by the author, making for the object of the research.

In this case, therearises the problem of experience and abilities of the persons using engineering, as well as the level at which these are made, they can be used occasionally, for amounts that do not exceed the threshold of significance.

IV. CONCLUSIONS

Creative accounting emerged under the conditions of economic, social and legal development, following the phenomenon of globalization, on the basis of competitiveness, answering thus the new informational requirements coming from the users under the pressure exerted to reach certain indices.

As expected, financial-accounting engineering are analyzed both from a positive as well as a negativepoint of view, the boundaryelement in between the theories being given by abusively using the practices and the desire to deceit the users, not to offer equal chances on the market to all the actors involved in the economic life.

Controversies exist and shall exist, as in any other field relating to interpretability and flexibility, since the research area hasn’t yet reached its maximum. The study of creativity on accounting is still at the beginning, and shallcontinue to develop and gain new meanings, together with the movements emerged in the global economy.

In the opinion of all, the creativity characteristic should keep on defining a positive aspect, progress and innovation, reason for which we believe that the creative accounting

practices are a tool in improving the accounting science and in applying it. Without manifesting creativity, any other field would be poorer, including accounting, reason for which we must take advantage of its existence and extract the leverages that lay the basis of development and progress of this science, mainly from a legal and conceptual point of view. Still to maintain the positive character of creativity, we believe necessary to continue the research and implementation of the results obtained from it, with a view to reducing the negative influence of manipulation by mitigating abusive and unrightful practices.

#### REFERENCES

- [1] Atik, A. (2009), „Detecting income-smoothing behaviors of Turkish listed companies through empirical tests using discretionary accounting changes”. *Critical Perspectives on Accounting*, Volume 20, Issue 5, pp. 591-613 available on-line at: <http://www.sciencedirect.com>.
- [2] [Adrian Grosanu](#), Rachisan Paula Ramona and Berinde Sorin Romulus (2011) Study regarding the influence of Romanian accounting regulation on creative accounting techniques; *Annals of Faculty of Economics*, 2011, vol. 1, issue 2, pages 523-528;
- [3] Agostini, Marisa and Favero, Giovanni, Accounting Fraud, Business Failure and Creative Auditing: A Micro-Analysis of the Strange Case of Sunbeam Corp. (September 20, 2012). Department of Management, Università Ca' Foscari Venezia Working Paper No. 12/2012. Available at SSRN: <http://ssrn.com/abstract=2149552>;
- [4] Baker, C.R., Hayes, R. (2004) „Reflecting form over substance: the case of Enron Corp”. *Critical Perspectives on Accounting*, Volume 15, Issues 6-7, pp. 767-785, available on-line at: <http://www.sciencedirect.com>;
- [5] Benito, B., Montesinos, V., Bastida, F. (2008)- „An example of creative accounting in public sector: The private financing of infrastructures in Spain”. *Critical Perspectives on Accounting*, Volume 19, Issue 7, Pages 963-986, available on-line at: <http://www.sciencedirect.com>;
- [6] Dilip, K. S. (2006), ‘Creative Accounting in Bangladesh and Global;
- [7] Lambert, C., Sponem, S., 2005. Corporate governance and profit manipulation: a French field study. *Critical Perspectives on Accounting*, Volume 16, pp.717-748;
- [8] Feleaga Niculae, Taming the accounting jungle, *Economica*, Bucharest, 1996;
- [9] Feleaga N, Malciu L., Accounting policies and options, *Economica*, 2002;
- [10] Gearin M., Khandelwal S., A true and fair view or mandatory standards?, *Australian Accountant*, 1995, vol. 65, pp. 12-16;
- [11] Goel A., Thakor A., Why do firms smooth earnings?, *Journal of Business*, 2003, vol. 76, no.1, pp. 151-192;
- [12] Jones M., Creative accounting, Fraud and International Accounting Scandals, John Wiley and Sons Ltd, London, 2011;
- [13] Loren Brandt, Johannes VAN BIESEBROECK, and Yifan ZHANG. "Creative Accounting or Creative Destruction? Firm-level Productivity Growth in Chinese Manufacturing" *Journal of Development Economic* 97.2 (2012): 339-351. Available at: <http://works.bepress.com/yfzhang/4>;
- [14] McBarnet D., Whelan C., Creative Accounting and the Cross-Eyed Javelin Thrower, John Wiley and Sons, Ltd., London, 1999, pp. 102;
- [15] Naser, C. (1993). Creative financial accounting: its nature and use, Pretince Hall, quoted by Feleaga N., Malciu L., Accounting policies and options, Fair Accounting versus Bad Accounting, *Economica*, Bucharest, 2002;
- [16] Nisulescu Ileana, Enterprise financing and restructuring, Infomedica Publishing House, Bucharest, 2000;
- [17] Vinnari, E.M., Näsi, S., (2008) „Creative accrual accounting in the public sector: 'milking' water utilities to balance municipal budgets and accounts”. *Financial Accountability & Management*, Oxford, Vol. 24, Iss. 2; pg. 97, available on-line at: <http://www.proquest.co.uk>;
- [18] Vladu Alina Beatrice and Adrian Grosanu (2011), Same insights regarding creative accounting in Romanian accounting environment-regulators, financial auditors and professional bodies opinion, *Annals of Faculty of Economics*, 2011;
- [19] Watts, R.L., Zimmerman J.L., 1990. Positive accounting theory: A ten year perspective, *Accounting Review*, 65, pp.131-156;
- [20] Young M.R., Accounting Irregularities and Financial Fraud: A Corporate Governance Guide, 2000, pp. 13.