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The Use of Accounting Judgement in the Application of Creative Accounting Policies and Practices

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Abstract: Creative accounting emerged at the beginning of the last century in the economies of Anglo-Saxon countries to respond to the increasingly varied requirements of users of accounting information in the context of the growing complexity of economic reality. Financial interests and business pressures have led to the use of specific policies and treatments by accounting professionals to cosmetise financial statements and thus, at the limit of legality, to provide accounting information consumers with the "truth" they want. In order to present the information users want, accounting professionals draw on their specialist knowledge, accumulated experience and professional judgement, thus demonstrating their skill and expertise in handling 'figures'. This paper aims to present the role of professional judgement in the emergence and development of creative accounting in contemporary society. In this regard, it will analyse how professional judgement is used to obtain relevant information on the financial position and performance of the economic entity, premises, techniques and methods of creative accounting, all accompanied by case studies on the evaluation of financial indicators using creative accounting techniques and methods and the impact of creative methods on the decisions of users of accounting information, especially in the process of evaluating annual financial indicators.

Keywords: professional judgment; creative accounting; financial position; financial performance; financial indicators; techniques

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1. Introduction

The phenomenon of globalisation, in particular the diversity of modern economic life, has made information increasingly necessary for making relevant decisions. Over time, changes in legislation and regulations in the tax and accounting fields have led to the emergence of ways of presenting economic information that reflect the real situation of entities more or less transparently. The objective of an economic entity operating in a highly competitive economy and using limited resources is, in fact, to rationalise its activities. Information is a key efficiency tool and one of the richest resources of our time.

The idea behind this study is to introduce various aspects of the use of creative accounting, starting with the practitioner's method, which will help us in the future to more easily identify cases where distortion of undesirable truths or events concerning financial situations has been used and, at the same time, to deal with these problems by further analysing the motivation for using this method and the consequences of its application. We believe that being creative in accounting is the result of the flexibility allowed by the accounting rules in place which, when used in good faith, helps to present the true financial position and performance of entities. Scientific research in this area of creative accounting has not yet reached a very advanced stage of development because the subject is still sensitive to issues of professional ethics.

The approach from the point of view of the evaluation of the indicators in the annual financial statements in the process of analysing the techniques and methods used by an economic entity is less addressed, which is why we proposed to choose this topic. The present paper has not set out either to advocate or to combat the use of creative accounting techniques; what we aim to do is to produce a research study that develops various aspects of creative accounting through the prism of its multiple approaches, discusses the main avenues of development and presents, in a pragmatic way, the implications of creative techniques on the decisions of the various users of financial-accounting information.

Therefore, we set out to address the issue of valuation in the process of analyzing the annual indicators presented in an entity's annual financial statements leading to a broader understanding of the role of creative accounting.

2. Literature Review

The content of this scientific approach has been developed in accordance with a number of papers, studies and articles in the international and national literature that have aroused our interest in this controversial and fascinating subject of creative accounting. Thus, the most relevant of these, the ones that challenged us to study the field of creative accounting, in our opinion, are the following:

Naser K., in the paper *Creative accounting: it's nature and use*, defines from an academic perspective creative accounting as "the process by which, because of flexibility and the existence of gaps in the rules, figures in annual accounts are manipulated, the result of the choice of measurement and reporting practices being the transformation of summary documents from what they should be to what managers" (Naser, 1993) want them to be "and points out that "the manipulation of accounts is an old accounting problem that appeared as early as the 1920s".

Colasse B., in his work *Comptabilité générale*, notes the possibility of creative accounting techniques becoming illegal as a result of the misappropriation of accounting rules: "accounting information practices often bordering on the legal are used by certain entities that take advantage of the limits of regulation and standardisation in order to embellish the image of their financial position and reported economic performance" (Colasse, 1997).

The opinion expressed by Giot, H. and Malo, L. in *L'élasticité du résultat selon les dimensions temps et espace* is also shared by other French authors who come to the defence of creative accounting which they say "is virtuous because it provides accounting with the means to develop at the same pace as markets and financial products", while "certainly representing a logical and natural development in the practice of accounting specialists" (Giot & Malo, 1995).

In his work *Comptabilité créative*, Stolowy H. refers to creative accounting techniques as "a set of procedures aimed either at modifying the result in order to maximise or minimise it, or at modifying the presentation of the annual financial statements, without, however, the two objectives being mutually exclusive" (Stolowy, 2000, pp. 157-178), these aspects being a significant part of the subject matter of this scientific research.

McEnroe J.E. addressed the issue of financial scandals caused by the use of creative accounting techniques in his study entitled *Individual Investors' Perceptions Involving the Quality and Usefulness of Audited Financial Statements* and highlights the negative effect they have on confidence in reported financial-accounting information (McEnroe, 2007, pp. 63-79).

Beneish M.D., in *The Detection of Earnings Manipulation*, identified a number of indicators that can be used to detect the risk of manipulation of information provided by annual financial statements. On the basis of these indicators, the author defined a linear function score using multivariate statistical analysis techniques (Beneish, 1999, pp. 24-36).

In line with the topic addressed in this scientific research, we observe a certain interest in the national literature as well, thus the concerns of recent years have been materialized in new writings, perspectives and visions regarding creative accounting.

In contrast to the international literature, however, we note a paucity of publications, studies and papers addressing this controversial topic.

Among the works, studies and analyses carried out on a national level, the most relevant among those consulted in order to build this scientific approach, we consider to be the following:

The first author who ventured to tackle the subject of creative accounting in our country was the late Professor Nicolae Feleagă, who in his work published in 1996, *Accounting controversies, conceptual difficulties and the credibility of accounting* (Feleagă N. , 1996), talks about the techniques of this type of accounting, as well as the risks involved in their use in accounting practice.

Three years later, Liliana Malciu presents in a detailed manner the ideas of her mentor in the above-mentioned paper, addressing conceptual issues concerning the complex motivations behind the development of creative accounting techniques, the practices arising from the choice of accounting policies or the reaction of the accounting profession to the emergence of this phenomenon (Malciu, 1999). *Creative Accounting* is peppered with practical examples describing the methods of modelling the balance sheet and profit and loss account and highlighting their impact on the financial position and performance of the entity.

The paper *Accounting Policies and Options (Fair Accounting versus Bad Accounting)* written by Feleagă N. and Malciu L. discusses the issue of choosing and developing accounting policies and divides them into two categories: those aimed at achieving honest accounting versus those used to manipulate financial statements (Feleagă & Malciu, 2002). The description of creative accounting techniques is approached in close connection with the negative effects on financial reporting and the need to define ways of limiting and combating them. Another aspect discussed by the two authors concerns the analysis of the professional ethics of those who use these practices.

Diaconu P., in *How do accountants make money? Tax evasion, tax havens, creative accounting* analyses the role of creative accounting in maximising the performance of economic entities (Diaconu, 2004).

Munteanu V. and Zuca M. in the article *Considerations on the use of creative accounting in distorting information in financial statements and "maximizing" the performance of the company*, consider creative accounting as a tool to support the manager, a tool used to present the desired image of the entity he manages in order to pursue his own interests (Munteanu & Zuca, 2011, pp. 3-10).

In the book *Creative Accounting*, Groșanu A. analyses the relationship between creative accounting and other concepts such as: true image, accounting fraud or corporate governance. He also brings to the fore a series of empirical studies aimed at helping users of the information provided by annual financial statements to understand creative accounting techniques and their impact in the Romanian economic environment (Groșanu, 2013).

Creative Accounting. From idea to money, with practical examples written by Dumitrescu A. S., proposes the search for positivism and negativism in the analysis of creative accounting. The author's perspective is clear: "creative accounting in the positive sense is able to emit an objective truth and message. And yet, let us not lose sight of the fact that the truth told by creative accounting is only a filter that cannot escape the constructed truth and the desired truth, between innovation and manipulation (Dumitrescu, 2014, p. 13).

The empirical study *Audit procedures for estimating fraud risk based on indices for detecting accounting manipulations* by Robu I.B. and Robu M.A. is based on the model proposed by Beneish (1999) and aims to obtain a scoring function applicable to Romanian listed entities (Robu & Robu, 2013, pp. 3-16). Thus, the authors aimed at creating an econometric model that allows the classification of these entities into groups of fraud risk caused by the manipulation of information in financial reports.

2. Research Methodology

The research undertaken in this scientific endeavour harmoniously combines elements specific to qualitative research with aspects involving quantitative research. As far as qualitative or interpretative research is concerned, a review of the literature was carried out in the belief that "scientific findings will be all the more convincing and precise if they are based on more bibliographical resources".

The quantitative or positivist research approached in the paper took the form of presenting practical examples specific to the field of creative accounting, analysing annual reports, calculating and interpreting economic and financial indicators that reveal the financial position and performance of the entity.

The following methods and techniques were used to carry out quantitative research:

- content analysis of financial reports published by the economic entity;
- comparative and correlative analysis of the research results;
- case study, used to reflect the picture of the financial position and performance achieved by adopting accounting policies with different objectives.

3. Using Professional Judgement to Obtain Relevant Information about the Financial Position and Performance of the Economic Entity

In addition to the help provided by accounting regulations, due to the complexity of economic activities, a professional in this field is faced with the situation of applying professional judgement in deciding how to record certain transactions, such as the recognition of property, plant and equipment which involves the use of professional judgement in applying recognition criteria to the specific circumstances of the entity.

For example, it may be appropriate to aggregate non-essential items such as moulds, measuring/control devices and instruments individually and apply criteria to the recognition of aggregate values. Also, in the case of fixed assets, to determine whether an asset that incorporates both tangible and intangible items should be treated as tangible or intangible assets, it is necessary to use judgement to assess which item is more significant.

Determining whether a property is investment property requires professional judgment. Entities need to develop criteria so that they can consistently use their arguments in accordance with the definition of investment property. In addition, when applying for the first time the regulations established by O.M.F.P. No. 1802/2014, "entities shall determine, based on accounting policies and professional judgment, which of the real estate properties held qualify as investment property"[1].

Perhaps the most important point in using professional judgement is the evaluation process. Assessment includes reasoning based on the latest reliable information available. Consideration should be given to whether the circumstances on which the assessment was based have changed due to new information or better experience. Accounting can be seen as a science or an art, but in the world of economists, accounting is very reliable. It is easy to imagine without knowing that the science of accounting is as accurate as mathematics. In fact, accounting information is neither simple nor accurate and rarely meets all the requirements of different users.

Accounting can be seen as a tool for expressing business life based on principles, rules and professional judgement. The ultimate goal of the entity is to create and present annual financial statements that give users of accounting information as realistic a picture as possible of their business. There are, however, many situations where users of accounting information may be influenced in one direction or another by the presentation of distorted accounting pictures and thus their behaviour may be manipulated. The presentation of artificial accounting pictures only highlights the asymmetry of information and affects the functioning of financial markets. However, in the context of the international phenomenon of accounting harmonisation the

[1] O.M.F.P. No. 1802 of 29 December 2014 - Part I approving the Accounting Regulations on individual annual financial statements and consolidated annual financial statements, published in the Official Gazette no. 963 of 30 December 2014, updated in 2022.

quality of financial reporting and accounting itself has improved considerably in recent years. “Overall, the development of society and the modernisation and restructuring of the economy have increased and diversified the demand for information in the financial-accounting sector” (Cucui, 2006).

Optimising demand management of scarce resources is necessary to permanently reduce sudden expenditure in order to increase profits. Thus, the European Union is trying to align accounting standards with International Financial Reporting Standards (IFRS) to use a common language in business by defining a common ground: European and American accounting.

Accounting is a means of representing an entity, and financial reporting based on accounting principles must give a true and fair view of reality. However, accounting information can be distorted and user behaviour can be manipulated. The person responsible for managing the format and content of the financial statements produced by the entity ensures that together they form a ‘picture’ that is favourable to them, using creativity and artistic skills. They certainly do not make serious efforts to satisfy the needs of all stakeholders. Accounting arose from the need to keep a long-term record of everything that occurs from an economic and financial perspective within an entity, not only for experts in other disciplines, but also for the general public and users of accounting information.

However, over time, more and more scandals have arisen as a result of breaches of accounting regulations, exposing them in the eyes of the aforementioned and tarnishing this “clean” image that the whole accounting phenomenon possesses. Even though the accounting world is outraged by the situation they find themselves in as a result of the emergence of several similar phenomena, experts seem reluctant to admit that it all started with them, with the help of various tricks they used for their own purposes in accounting management to get the desired results both personally and professionally. Economic reality is, in fact, an accumulation of activity within the economy, the normative representation of which provides for records to express exactly what is required, according to the accounting rules of the day, economic reality as it should be. In O.M.F.P. no. 3055/2009 for the approval of Accounting Regulations in compliance with European Directives, as amended and supplemented, repealed and replaced by O.M.F.P. no. 1802/2014, “Normalization is defined as the process of deliberate application of accounting rules for the correct solution of problems concerning the production and use of accounting information”[1].

The theoretical and practical development of accounting should depend to a large extent on the cultural environment of each country, and it goes without saying that

[1] O.M.F.P. No. 3055, for the approval of the Accounting Regulations in compliance with the European Directives, published in the Official Gazette, Part I, no.766 of 29 October 2009, item 259, paragraph 1. (1) - (2).

all its components, such as economics, politics, finance and even religion, define each territory.

“The choice and design of an accounting system must take into account the fact that no accounting system is perfect for the economic realities of a country (...) The design of a national system is a complex political-strategic process, taking into account the international accounting geography and the particular interests of each country” (Apostol, 2010, p. 37). We must therefore continually adapt to everything that is new in this field. However, this is very difficult due to the lack of a common language in international accounting.

Each country has its own way of expressing its needs and meeting them. This has also affected accounting, which needed uniformity, and which was achieved through standardisation and harmonisation of regulations. Harmonisation is “the process by which national rules or standards, different from one country to another, sometimes divergent, are refined to make them comparable” (Petriș, 2005). But in addition, accountants face a number of ways in which competing entities demonstrate their identity because of the wider sector of the economy to which they belong. The need for accounting information is faster and more varied as managers want to use it to attract as many third parties as possible and to differentiate themselves from other entities in the same industry, thereby improving both their image and their financial standing.

Therefore, accountants have been looking for different solutions not only to meet managers’ requirements but also to address the rising tide of information requirements. But when an entity needs an additional image, the solution is innovative, creative, one step ahead of the norm and does not break the law, but takes advantage of its “shortcomings”. In addition, because of the uncertainty surrounding an entity’s business, more and more figures are estimated in financial statements because they cannot be reliably measured.

“This is where the company manager steps in and chooses from the myriad of accounting treatments and policies the one that suits his or her interests, which leads us to believe that the outcome may be convenient and not necessarily faithful” (Munteanu & Zuca, 2011, p. 3). The estimation process includes judgments based on the latest available and reliable information. For example, estimates may be required for: uncertain customers, depletion of inventories, fair value of financial assets and liabilities, useful lives and expected use of economic benefits from depreciable assets, liabilities arising from guarantees, etc.

So there are various ways in which accountants try to “decorate” or, why not, represent the so-called “economic reality” rather than the real one. However, instead of respecting the real picture, each accountant using these things presents a “real picture” according to their own economic reality. “Creative accounting, therefore, determines those accounting methods and techniques that are expected to produce results as close as possible to what managers want in reality. In other words, they take advantage of loopholes, inaccuracies or inconsistencies in tax regulations to maximise, as far as possible, the impact of the tax burden on the entity's accounting result" (Dinga, 2008, p. 3).

But while creative accounting adjusts an entity's image, it cannot be equated with fraud or unfair conduct that violates the law. *Creative accounting fully complies with the rules, but not the spirit of the rules*. "The procedures used in creative accounting are based on accounting rules, but also on professional judgment" (Ionescu, 2006).

In the main, continental accounting systems regard creative accounting as an obstacle to creating a true picture, as a misleading and undesirable practice, whereas Anglo-Saxon accounting systems show flexibility and freedom of judgement, of professional judgement and action, of choice in constructing and rendering true pictures. The relativity of the concept of a clear/correct picture is due to the presence of different users with different requirements, and it is known that "there are as many truths as there are recipients of information". Consequently, the subjective element of the image user's perception of the presented reality comes into play, i.e. the perception set differently both in terms of the purpose of image use and the degree of image perception. Recognition of the real image depends not only on the establishment of accounting rules, but also on the user's understanding and acceptance of them.

This means that the true picture is, for the author of the accounting report, in the sense that all the rules are applied to see whether the resulting solution can help users to minimise distortion of the entity's image. It is a test. Creative accounting is only true if the flexibility allowed by the accounting rules is used to shape the interests of a small number of users of accounting information to the detriment of the majority of users. This plays a negative role in its creation.

4. Premises, Techniques and Methods of Creative Accounting

Creative accounting is the process by which an accounting professional uses his or her knowledge to manipulate accounting information and take advantage of the many legislative options available to interpret regulations and solve the various accounting problems facing an entity at any given time. All of this involves choosing measurement and presentation methods that allow the reporting of financial information to change from what it should be to what managers want it to be. Thus, creative accounting is that process by which desired accounting results can be achieved, a process that leads to structured results to authorise the process of creating the assets necessary for the existence and development of the entity (Figure 1):

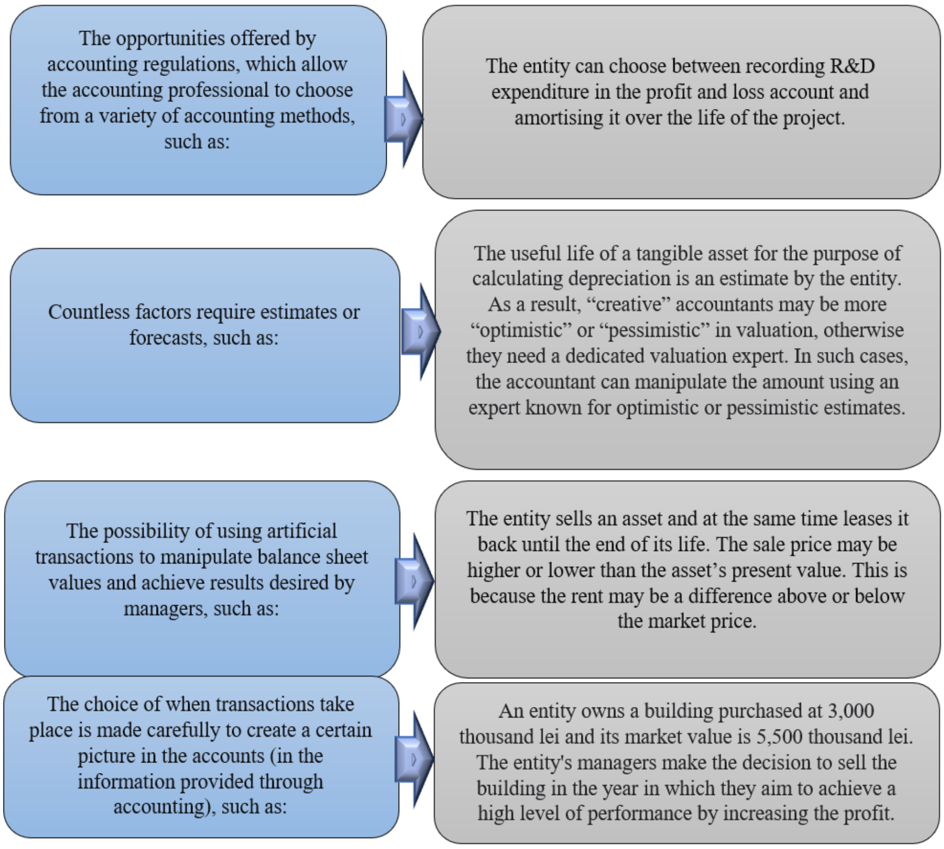


Figure 1. Relevant Premises of Accounting Creativity
Source: processing authors

The criteria used to present accounting information can be creatively flawed. The easiest way to manage financial information is to take advantage of the flexibility of accounting standards. According to Levitt, "accounting standards should be interpreted in accordance with the purpose for which financial reporting is intended, and misleading reporting to users of financial statements is not desirable" (Levitt, 1998). Financial reporting clearly solves the problem of ambiguous judgments and estimates, difficulties in presenting complex transactions and, in particular, the distortion of routine transactions and events.

"The dynamism and creativity of the accounting profession are underpinned by the avalanche of new challenges posed by the development of production and trade, the service sector, the encouragement of private initiative, the increase in the number of entities of all types, the onset and intensification of stock exchange activity, financial transactions, the emergence of merger operations and bankruptcy phenomena, the development of credit institutions, inflationary influences, the constant improvement in the quality of domestic and international accounting, financial reporting and auditing standards and regulations" etc.. (Cucui, 2006, p. 1). The aim pursued determines appropriate and specific mechanisms and procedures for creative accounting (Figure 2):

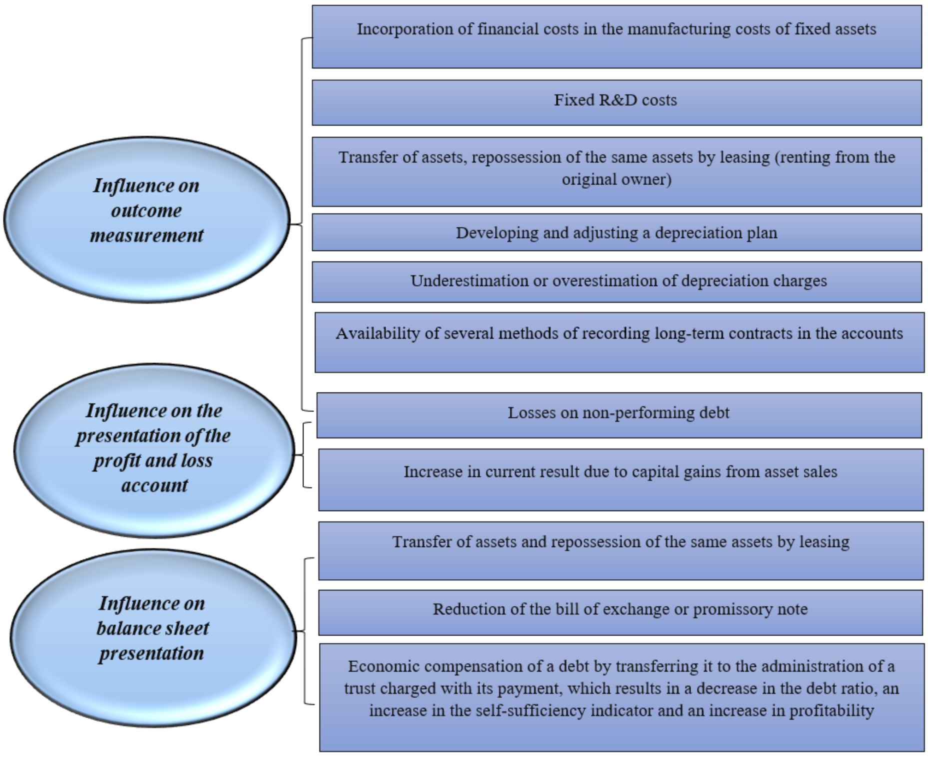


Figure 2. Appropriate Mechanisms and Processes Subject to Creative Accounting According to Purpose

Source: authors' processing, adapted from N.Feleagă, Controverse contabile, Economical Publishing House 1996, p.148.

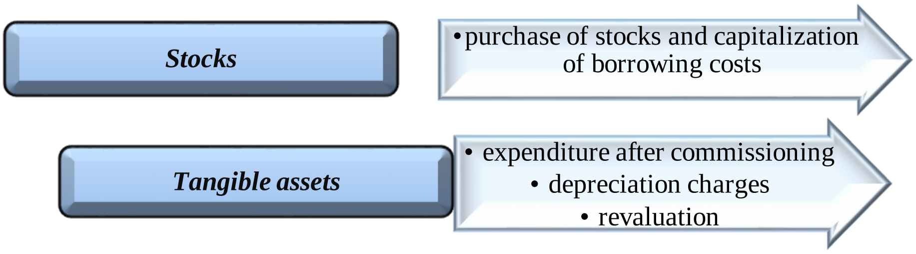
In Romania, the accounting professional's desire for creativity focuses mainly on the following elements: adjusting the size of the accounting result which is also the starting point for determining income tax, excessive emphasis on accounting results when determining the entity's book value. These elements influence other indicators, namely: turnover, net book assets and size of cash flow. Thus, creative accounting is polarised into three areas: increasing capital, lowering debt ratios and maximising earnings.

5. Evaluation of Financial Indicators using Creative Accounting Techniques and Methods

"The primary purpose in assessing relevant indicators in annual financial reports is to provide useful information to assist users of financial statements in the decisions they make about an entity's position and performance (IASB, 2015)"[1], their emergence highlighting the existence of information asymmetry between financial information providers and users.

At the mission level, "the financial evaluator should place particular emphasis on the cycle of turnover transactions, verify how these transactions have been recorded and test compliance with the applicable accounting framework. In checking the transactions, the valuer may observe the appearance of accounting distortions" (Jaba, Robu & Robu, 2014, pp. 18-29).

In the present approach to the evaluation of the indicators related to the annual financial reports of the entity SC "ROFRA" SA, the following creative accounting techniques and methods were used:



The treatment of inventories will be carried out under IAS 2 "Inventories" and IAS 23 "Borrowing Costs". Expenditure incurred in the acquisition of inventories will be handled in terms of whether or not it is included in the cost of acquisition through the permitted alternative accounting treatment, which applies to inventories that take a significant period of time to get ready for use or sale. The treatment of property, plant and equipment will be within the ambit of IAS 16 Property, Plant and Equipment for post-commissioning costs, subsequent expenditure associated with an item of property, plant and equipment that has already been recognised and should be added to the carrying amount of the asset only when future economic benefits are expected to flow to the entity over and above the originally estimated performance, as necessary.

[1] IASB (2015), International Financial Reporting Standards (IFRS) Official regulations issued from January 1, 2015, CECCAR, Bucharest.

According to the Accounting Regulations on the Separate Annual Financial Statements and Consolidated Annual Financial Statements approved by O.M.F.P. No. 1.802/2014, as amended, “entities must develop their own accounting policies”[1].

According to the provisions of the accounting regulations, accounting policies are the specific principles, frameworks, conventions, rules and practices applied by an entity in the preparation and presentation of annual financial statements. Accounting policies and valuation techniques/methods should be applied consistently from one financial year to the next. One of the accounting policies is to revalue property, plant and equipment or to retain their original cost. Other examples of accounting policies are: selection of depreciation methods for fixed assets.

The means of manipulating an entity’s performance is supported by the accounting methods and policies recommended by international accounting standards. The existence of possible “choices” in accounting that correspond to the choice of actual accounting methods or freedom of measurement in the presentation of financial statements may affect the performance and image of the entity, thus: “one of the means of manipulation can be applied on costs, which are composed of : purchase price, import and other taxes, except what the entity can do on recovery from tax authorities, transportation costs, other costs that may be directly due to the purchase of final products, materials and services”[2]. Costs are incurred depending on the desired outcome and the costs of purchasing an inventory are handled in the sense of whether the cost of purchase is included or not.

The entity SC “ROFRA” SA, considered in the research study, purchases goods under the following conditions: purchase price of goods 500,000 thousand lei, transport expenses 200,000 thousand lei, income from the sale of goods is 4,650,308 thousand lei. The manager of the entity is allowed to choose whether or not to include transport costs in the purchase cost, thus obtaining different accounting results (Table 1):

[1] O.M.F.P. No. 1802 of 29 December 2014 - Part I approving the Accounting Regulations on individual annual financial statements and consolidated annual financial statements issued by the M.F.P., published in the Official Gazette No. 963 of 30 December 2014, updated in 2022.
[2] IAS 2 “Inventories”, paragraph 8.

Tabel 1. Profit and loss statement - year 2018

- thousand lei -

Indicators	*Situation in which the expenditure of transport costs were included in the purchase cost*	*Situation in which the expenditure of transport costs have been excluded from the purchase cost*
Income from sale of goods	4.650.308	4.650.308
Expenditure on goods sold:	***(700.000)***	***(590.000)***
-purchase price	500.000	500.000
-transport costs	200.000	-
-handling costs	90.000	90.000
Accounting result	***3.950.308***	***4.060.308***

Source: authors processing

It can be seen that the entity's decision to include transport costs in the purchase cost resulted in lower results. If an entity faces difficult times, this can result in that picture being obscured and users being disappointed by that information. Managers will then be interested in finding ways to improve or maximise profit in the desired direction. Therefore, they decide not to include shipping costs in the purchase costs. From the data recorded in the profit and loss account it can be seen that this decision has caused the result obtained to be upward.

Another means by which costs can be manipulated is through the capitalization of borrowing costs. "The cost of inventories may also include the cost of debt"[1], which includes interest and other expenses incurred by the indebted entity. In accordance with IAS 23 "Borrowing Costs", capitalization of borrowing costs is required using a permitted alternative method of accounting that applies to inventory that is ready for use or sale for an extended period of time.

During the financial year 2018, SC "ROFRA" SA obtains finished products at production cost 15,500,000 thousand lei, excluding interest. The result obtained will be different, depending on the entity's decision whether to capitalize interest expenses or not. Due to the capitalization of interest expenses, the results of the entity's activity are significantly improved. The application of these accounting methods had the following impact on the profit and loss account (Table 2):

[1] IAS 23, paragraph 4.

Table 2. Profit and loss statement - year 2018

- thousand lei -

Indicators	*Capitalized interest*	*Uncapitalized debt*
Turnover	802.232.190	802.232.190
Change in stocks	18.850.000	15.500.000
Expenditure on raw materials and consumables	(188.035.700)	(188.035.700)
Expenditure on salaries	(302.535.600)	(302.535.600)
Other operating expenses	(228.502.782)	(228.502.782)
Operating result	102.008.108	98.658.108
Interest expenses	-	(3.350.000)
Accounting result	***102.008.108***	***95.308.108***

Source: authors processing

Recording interest expense in the cost of inventories distorted the fair view of the entity, resulting in an increase in the accounting result.

At the same time, the entity also switched to "treating tangible assets relating to future expenses associated with an item of land and fixed assets, already recognised, which should be added to the carrying amount of the asset only when it is estimated that the entity will obtain future economic benefits in excess of the performance initially estimated to be appropriate[1].

Therefore, towards the end of the 2018 financial year, the entity is renovating the building in which the administration department operates. The building was purchased 20 years ago at an initial price of 625,000 thousand lei with a useful life of 20 years. Repair costs amounted to 50,000 thousand lei. The managers appreciate the high degree of deterioration of the building and decide that it needs to be repaired to ensure continued functionality. The solution they suggest is not to recover the renovation costs. On the other hand, the entity's management plans to buy a new headquarters and sell the existing one, hoping that the renovation of the building will increase its market value. Thus, the managers might decide to benefit from the repair costs by capitalising them. How will this affect the outcome?

Capitalizing the renovation costs has the same effect on the result in the 2018 and 2019 financial years (note that turnover and other costs are variable), decreasing it by 49,500 thousand lei. The decision to charge expenses to the result of 2018 will reduce the result by 77,500 thousand lei. The situation in the profit and loss account is shown in Table 3 as follows:

[1] IAS 16, paragraph 23.

Table 3. Profit and loss statement 2018 -2019

- thousand lei -

Indicatori	***2018***		***2019***	
	Cheltuieli renovare		***Cheltuieli renovare***	
	Se capitalizează	***Nu se capitalizeaza***	***Se capitalizează***	***Nu se capitalizează***
Cifră afaceri	802.232.190	802.232.190	768.821.992	768.821.992
Cheltuieli renovare	-	(50.000)	-	-
Cheltuieli amortizare	(49.500)	(27.500)	(49.500)	(27.500)
Cheltuieli cu materiile prime și materialele consumabile	(188.035.700)	(188.035.700)	(191.136.199)	(191.136.199)
Cheltuieli cu salariile	(302.535.600)	(302.535.600)	(293.402.303)	(293.402.303)
Alte cheltuieli de exploatare	(228.502.782)	(228.502.782)	(201.125.382)	(201.125.382)
Impactul asupra rezultatului contabil	(49.500)	(77.500)	(49.500)	(27.500)
Rezultat contabil	***83.108.608***	***83.080.608***	***83.108.608***	***83.130.608***

Source: authors processing

When talking about depreciation charges on tangible assets, the depreciable cost of an asset should be allocated systematically over the useful life of that asset. Usually, a depreciation method is chosen that reflects the rate at which the future economic benefits from the use of the asset are consumed. Entities take advantage of the choice of different depreciation methods, which often lead to different results.

As at 31.12.2018, SC “ROFRA” SA purchased a vehicle with an initial value of 495,000 thousand lei, with a useful life of 10 years. In order to systematically allocate the value of vehicles, the entity’s managers can use the straight-line method, the declining balance method or the quick method. The situation of depreciation expenses determined by the three methods reflected in the income statement for 2019 is as follows: Direct depreciation expenses = 495,000 thousand lei x 10% = 49,500 thousand lei, Declining balance depreciation expenses = 495,000 thousand lei x 20% = 99,000 thousand lei sia Accelerated depreciation expenses = 495,000 thousand lei x 50% = 247,500 thousand lei.

Choosing the straight-line method creates the image of a more efficient entity. This is a misleading picture, because in 2020 the situation will change as follows: Depreciation expenses in 2020: Expenses with linear depreciation = 495,000 thousand lei x 10% = 49,500 thousand lei, Expenses with degressive/reduced depreciation = 396,000 thousand lei x 20% = 79,200 thousand lei and Expenses with accelerated depreciation = 247,500 thousand lei x 15% = 37,125 thousand lei. The situation in the profit and loss account is shown in Table 4. as follows:

Table 4. Depreciation Method account Sheet 2019-2020

- thousand lei -

Indicatori	***2019***			***2020***		
	Amortizare liniară	***Amortizare degresivă***	***Amortizare accelerată***	***Amortizare liniară***	***Amortizare degresivă***	***Amortizare accelerată***
Cifră afaceri	768.821.992	768.821.992	768.821.992	835.289.700	835.289.700	835.289.700
Cheltuieli amortizare	(49.500)	(99.000)	(247.500)	(49.500)	(79.200)	(37.125)
Cheltuieli cu materiile prime și materialele	(191.136.199)	(191.136.199)	(191.136.199)	(226.304.500)	(226.304.500)	(226.304.500)
Cheltuieli salariale	(293.402.303)	(293.402.303)	(293.402.303)	(294.395.536)	(294.395.536)	(294.395.536)
Alte cheltuieli de exploatare	(201.125.382)	(201.125.382)	(201.125.382)	(231.431.556)	(231.431.556)	(231.431.556)
Rezultat contabil	***83.108.608***	***83.059.108***	***82.910.608***	***83.108.608***	***83.078.908***	***83.120.983***

Source: Authors Processing

The graphical analysis of the application of the three depreciation methods, correlated with the results recorded by the entity, is presented in Figure 1, as follows:

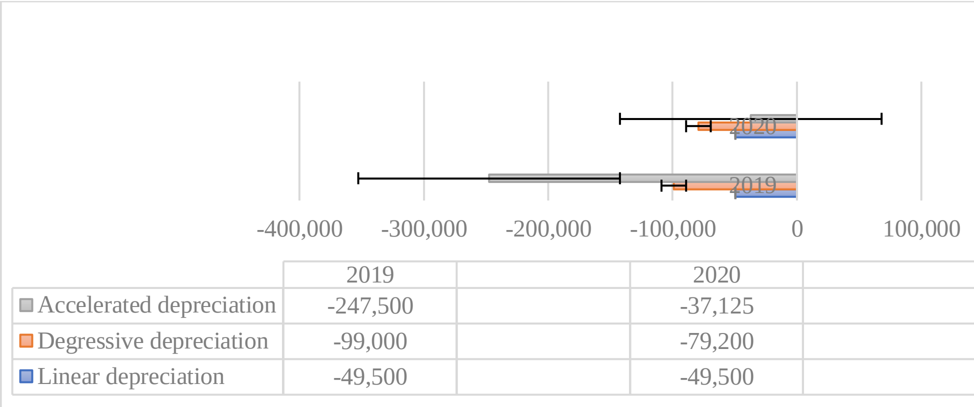


Figure 1. Evaluation of the Indicators made by SC ”ROFRA” SA Following the Application of the Depreciation Methods of a Fixed Asset

Source: Authors Processing

As can be seen from the analysis of the indicators in Table 4, as well as from the graphical analysis above, unlike in 2019, when the ideal depreciation method was straight-line, in 2020 the accelerated method improves the performance of the entity. We also note that using the straight-line depreciation method the result is the same, while the declining balance method decreases it.

At the same time, in 2020 SC "ROFRA" SA decides on accounting techniques and methods for revaluation of fixed assets, which leads to manipulation of the results in the desired direction.

Although the process of revaluation of tangible fixed assets is at first glance an ordinary event, this method can distort the results of the entity. When difficulties arise, many entities use this accounting method as a last chance to improve the results reflected in changes in equity.

The analysed entity owns a production workshop purchased at a value of 700,000 thousand lei; depreciated cost of 150,000 thousand lei. The remaining life is 10 years and it is depreciated on a straight-line basis. At the beginning of 2020, the management of the entity takes the decision to revalue this tangible fixed asset, whose fair value is 800,000 thousand lei. The revaluation reserve will amount to MDL 250,000 thousand (MDL 800,000 thousand - MDL 550,000 thousand). The results of the entity's operations before and after the revaluation, reflected in the statement of changes in equity, are shown in Table 5:

Table 5. Statement of Changes in Equity Before and After Revaluation of Fixed Assets and Profit and Loss Account in the Financial Year 2020

- thousand lei -

Indicators	Before the re-evaluation	After the re-evaluation
Subscribed capital	256.930.502	256.930.502
Revaluation reserves	135.803.395	136.053.395
Total equity	***392.733.897***	***392.983.897***
Turnover	835.289.700	835.289.700
Depreciation expenses	(55.000)	(80.000)
Raw materials and consumables	(226.304.500)	(226.304.500)
Salary expenses	(294.395.536)	(294.395.536)
Other operating expenses	(231.431.556)	(231.431.556)
Accounting result	***83.103.108***	***83.078.108***

Source: authors processing

The revaluation of depreciable fixed assets has led to an increase in depreciation costs and consequently to a decrease in the result. The annual depreciation before revaluation was RON 55,000 thousand (RON 550,000 thousand x 10%) and after revaluation it was RON 88,000 thousand (RON 800,000 thousand x 10%). Thus, after revaluation, the result was reduced by RON 25,000 thousand.

In the desire of managers to counter the decline in earnings, entities choose to revalue assets that are not depreciable. In order to overcome the barrier of decreasing the result, the revaluation surplus can be charged to the revaluation reserves. Thus, annual depreciation of 80,000 lei will increase depreciation expenses by 8,000 thousand lei and reduce the revaluation reserve by 25,000 thousand lei (250,000 thousand lei: 10 years). The situation of the change in equity due to revaluation is presented in Table 6:

Table 6. Statement of Changes in Equity Before and After Revaluation of Non-Depreciable Fixed Assets and Profit and Loss Account in the Financial Year 2020

- thousand lei -

Indicators	Before the re-evaluation	After the re-evaluation	After the re-evaluation
Subscribed capital	256.930.502	256.930.502	256.930.502
Revaluation reserves	135.803.395	136.053.395	135.778.395
Total equity	***392.733.897***	***392.983.897***	***392.708.897***
Turnover	835.289.700	835.289.700	835.289.700
Depreciation expenses	(55.000)	(80.000)	(8.000)
Raw materials and consumables	(226.304.500)	(226.304.500)	(226.304.500)
Salary expenses	(294.395.536)	(294.395.536)	(294.395.536)
Other operating expenses	(231.431.556)	(231.431.556)	(231.431.556)
Accounting result	***83.103.108***	***83.078.108***	***83.150.108***

Source: Authors Processing

Note: The revaluation surplus is charged to the revaluation result on changes in equity and to the revaluation result on the profit and loss account.

In the case of the revaluation of a building at a lower value when there has previously been a revaluation at a higher value and the current revaluation loss was lower than the previously established reserve, the revaluation gain is charged to the revaluation result as follows:

105 “Revaluation reserves”	=	212 “Fixed assets”	275.000 thousand lei

After evaluating the data presented, we note an increase in the accounting result by 72.000 thousand lei, which artificially contributed to the achievement of what the entity’s managers wanted. They took advantage of the provisions of IAS 16[1], which stipulates that depreciation for a given period is generally recognized as an expense or may become part of the cost of another asset, without prohibiting the partial allocation of depreciation to revaluation reserves.

The revaluation surplus included in the revaluation reserve is recognized by transfer to retained earnings (account 1175 ‘Retained earnings representing realized surplus

[1] IAS 16 paragraful 48.

on revaluation reserves') when the asset is derecognized or as the asset is used, in accordance with International Financial Reporting Standards (IFRSs).[1]

212 "Fixed assets"	=	1175 "Retained earnings representing realised surplus on revaluation reserves"	thousand lei

6. Impactul metodelor creative asupra deciziilor utilizatorilor de informații contabile, în special în procesul de evaluare al indicatorilor financiari anuali

In a context where creative accounting is seen as a problem, this topic should not be avoided, but should be discussed and explored further. A positive approach to the subject is far from our intentions, the purpose of this article is not to offer ideas based on creative accounting practices in meeting entities objectives, to the detriment of users and their interests, but to warn accounting professionals of the dangers that lurk in such practices, as users are exposed to the negative consequences of creative accounting for the quality of information provided, with reference to financial indicators, all the more so as many accounting professionals "would not shy away from using creative accounting practices as long as they would not break the law" (Cernușca, David, Nicolaescu & Gomoi, 2016, pp. 63 – 87).

In the quest to decode the "Pandora's box", as some experts in the field of creative accounting call it, opinions differ from case to case, generating various controversies. There is no doubt that it distorts the quality of financial information, results and performance, implicating less scrupulous managers, accountants, valuators and auditors who, in questionable ways, seek to gain undue advantage. Although it differs from accounting fraud in that it follows the rules, standards and letter of the law, but not their spirit, all this does not make creative accounting any less perfidious.

On the contrary, it makes it more deceptive and harder to detect. The fight against such practices is also called for as long as we cannot rely on the morality of those involved, as creative accounting is a matter of ethics and principles. It derives from the inherent subjectivity of the professional judgement used in interpreting economic transactions, establishing correlations, choosing accounting policies and the possibility of transforming a credible/trustworthy image into a desired image of the entity. The victims of this phenomenon are the users of financial statements, the focus being on discretionary texts, cash flow statements and a more detailed analysis of the information available to all stakeholders.

[1] International Financial Reporting Standards, Official Gazette no. 424 of 26.06.2012, with subsequent amendments and additions.

Creative accounting is a highly controversial topic that has been discussed over the past decades. A large number of those who have researched the subject of creative accounting have given various definitions to highlight its main characteristics. In these definitions, different objectives and more or less meticulous ways of using creative accounting are highlighted, as well as factors that contribute to creative thinking in accounting. The purpose of financial statements is to provide financial information that will be useful to existing and potential investors, creditors and other existing and potential creditors in making decisions about the provision of resources to the entity under review. “The quality of information influences the effectiveness of decisions” (Horomnea, Pascu & Istrate, 2012).

Therefore, for information to be useful in decision-making, it must meet certain qualitative requirements: relevance and accurate presentation, comparability, verifiability, timeliness and understandability. But these are abstract and relative concepts that provide grounds for the “quick manifestation of the instinctive perversity of business people” (Giot & Malo, 1995).

“Accounting creativity occurs when the accounting professional together with the entity’s managers takes advantage of the flexibility of accounting rules to control the measurement and presentation of all items in the financial statements so that they serve the interests of the entity and not the users” (Mardiros, Dicu & Grosu, 2015). This is a weapon used by managers in the conflict of interest that exists between them and other users. Using creative arguments, professional accountants can solve scripturally what the business or managers themselves cannot do because of their capacity. The main line of action for styling the image presented in financial statements is to “produce” the desired accounting result (Naser, 1993).

For large listed entities and in the Anglo-Saxon accounting environment, profit maximization may be the objective to attract investors. To the same end, it may be desirable to break even each year. Exceptionally, suppose the entity has a good year . Since we cannot expect comparable results to the current year in the next few years, it is desirable to carry forward some of the results to the next year so that the difference between one year and the next is not visible and negative results do not occur in the business. This strategy is known in the literature as smoothing the results or smoothing the profit. On the other hand, it is possible to reduce taxation and minimize the results.

Schematically, the implications of using creative accounting methods and techniques are shown in Figure 3 as follows:

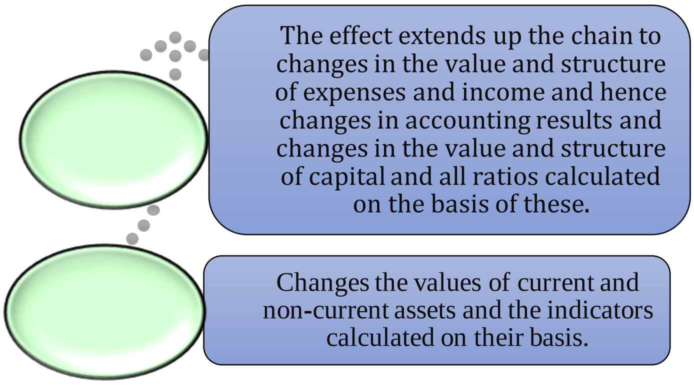


Figure 3. The Implications of Using Creative Accounting Methods and Techniques on the Quality of Information in Financial Statements Include

Source: authors' projection, adapted from Tabără N. & Rusu A. (Tabără & Rusu, 2011, pp. 37-44)

In other words, "creative accounting distorts the results and financial position relating to the entity and leads to the creation of an altered impression of business performance (Mulford & Comiskey, 2002).

7. Negative and Positive Effects of Creative Accounting

Creativity in accounting can be used according to the accountant's intention, both to manipulate financial statements and to find new solutions and accounting methods to problems faced by a company. "The positive or negative side of creative accounting is given by the many motivations for its use" (Comandaru, Stanescu, Toma & Păduraru (Horaicu), 2020, pp. 100-110).

In general, creative accounting has *negative implications*. It is believed to be a mechanism for manipulating the information that financial statements contain, primarily to mislead investors and authorities. As a result, financial statements are prepared with managers' requirements for the financial position and performance of the entity in mind, using techniques and methods that result in fictitious profit increases to attract investors or show lower results for taxes owed to the state.

Potential warnings about the consistency of accounting information are also recognised by the *International Accounting Standards Board's* (IASB) conceptual framework "most financial information is subject to some risk of giving a less reliable representation than it should”[1], which seeks solutions to limit creative accounting. The negative effects have spread to the macroeconomic level and have become increasingly evident with the onset of economic crises and the triggering of major financial scandals has usually resulted from the use of proper accounting techniques.

David Schiff, made the claim: “Creative accounting is a recipe for disaster” (Schiff, 1993). This recipe for disaster has been translated by some experts as ‘crisis advice’. The financial analyst Smith (Smith, 1992) “deduced that much of the economic growth of previous periods was more the result of the ingenuity of accountants than real growth”.

The positive aspect of creative accounting and the techniques and methods it employs is the convenient way of tracking new accounting problems, finding solutions and representing the financial position and performance of an entity’s business as accurately as possible. In addition, any form of creative accounting is represented by professional judgement which is even reflected in accounting rules, which require that, when the application of rules is not sufficient to truly reflect reality, one should deviate from the rules by applying professional arguments.

8. Conclusions

From the techniques presented, the hypothesis is demonstrated that “accounting truth is not absolute, but rather constructed” (Firescu, 2014). Users’ confidence in the quality of financial information, accounting principles, all requirements aimed at ensuring the quality of financial statements and the validity of financial statements represent an opportunity to manipulate them. Although everyone understands by true and fair view what needs to be understood, in reality, the choice of a method that reflects reality is subjective. The aim pursued is decisive in the application of creative accounting techniques and will not be achieved if the objective does not deviate from this principle and focuses on the users of financial statements with all subjectivity. The latter occurs when the target is in the self-interest of the entity, using a convenient image instead of the true picture. From the perspective of those with a direct stake in the entity’s reputation, they see creative accounting as a lifesaver in difficult situations where things are not going well and is viewed as a negative by those with a stake in the entity’s actual performance.

At the same time, creative accounting is a skilful weapon used by managers in the conflict of interest that exists between them and other stakeholders, but evaluation, auditing, corporate governance, the accountant’s judgement in applying the clearest

[1] IASB (2015), International Financial Reporting Standards (IFRS) Official regulations issued from January 1, 2015, CECCAR, București.

and most precise accounting methods and techniques that ensure the accuracy of information as well as its transparency are ways of resolving conflicts of interest. If we consider the accounting treatments used in the evaluation made in the present article of the financial indicators of SC “ROFRA” SA, for the period 2018-2020, we can state that its long-term existence depends on its ability to generate satisfactory profits at least. An investor becomes and remains a shareholder of an entity if he believes that dividends and other capital income will be higher than the income from other investments with a similar level of risk. In this context, profit, as an absolute indicator of profitability, is both a business premise and an outcome. Therefore, the assessment of the quality of the profits obtained must be a permanent concern for both the entity’s manager and the experts in the field. The freedom of choice of accounting method by the entity’s management, leading to an increase or decrease in the result, is in our opinion one of the main informational limitations of the profit and loss statement. Moreover, in practice, accountants use existing rules to make estimates and forecasts or rely on alternative authoritative accounting treatments to create creative accounting methods that are often restricted by existing legislation.

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