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The Impact of the Use of Creative Accounting Techniques and Practices on the Financial Position and Performance of Economic Entities – Theoretical and Applied Particularities

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Abstract: The theoretical approach of creative accounting techniques and practices captures the way in which the accounting information that characterizes the financial position and performance of the economic entity is influenced. The presentation of the numerous typologies of techniques and practices specific to creative accounting is necessary for all categories of users of financial-accounting information because in this way their effects on the annual financial statements are (re)known and economic decisions are made in the knowledge of the case.

Keywords: creative accounting; techniques and practices of creative accounting; financial position; financial performance; economic entity; manipulation of financial statements

JEL Classification: M41

1. Introduction - Creative Accounting Techniques and Practices: Theoretical Approaches

The specialized literature confirms the existence of an impressive variety of ***creative accounting techniques and practices*** that allow changing the level of the result reported upstream, through the profit and loss account, respectively downstream, through the balance sheet (Degos, 2002, pp. 54-68). Research undertaken to detect and identify creative accounting practices looked at the impact of their use on the balance sheet and profit and loss account. In this sense, there are authors (Stolowy, 1999, pp. 157-178), who classify creative accounting practices into three broad categories:

1. accounting practices that affect the entity's performance (bottom line);

2. accounting practices with an impact on the preparation and presentation of the profit and loss account (accounting practices that affect the structure of the result: by changing the intermediate management balances, current and/or extraordinary results, but which do not have an impact on the net result);

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3. Accounting practices with an impact on the preparation and presentation of the balance sheet (accounting practices that affect equity, the degree of indebtedness, the need for working capital, treasury).

Consistent with this analysis is the following typology of classification, which is based on the division of creative accounting techniques into:

a) accounting practices that influence the profit and loss account:

- due to the limits arising from the application of accounting policies;
- due to the limits arising from the application of accounting principles;
- Due to the limits arising from management decisions.

b) Accounting practices that influence the balance sheet.

Following the main elements of the balance sheet (Groșanu, 2013), four categories of techniques used by creative accounting are identified:

1. techniques regarding the handling of fixed assets;
2. techniques regarding the handling of current assets;
3. techniques that influence equity and debt;
4. Other creative accounting techniques.

Another proposal for the classification (Mulford & Comiskey, 2002) of creative accounting practices brings to the fore the criterion of evaluating assets, liabilities, income and expenses:

- Recognition of premature and fictitious incomes – the use of this technique involves the registration of incomes at a date earlier than that established by law or the registration of incomes that have not been realized, in order to artificially increase the turnover and the result. We draw attention to the fact that only the premature recognition of income can be considered a technique of creative accounting (entities can determine the way of recognizing income through accounting policies), but the registration of fictitious income goes beyond the legal scope of accounting rules and represents a fraud.

- Policies of aggressive capitalization of expenses and the use of extended depreciation periods – the use of this practice implies the reduction of expenses as a result of their capitalization and their transformation into fixed assets that are depreciated throughout their useful life. In addition, also in order to reduce expenses, depreciation is carried out over as long a period as possible.

- Erroneous reporting of assets and liabilities - through these practices, overvaluation of assets and undervaluation of liabilities is considered, thus reducing expenses and possible losses.

To these categories of creative accounting practices are also added:

- The creativity applied in the preparation of the profit and loss account - the practices that aim to manipulate the profit and loss account refer to the way in which a higher result is attributed to the current activity at the expense of the extraordinary activity, without the final result being affected.

- Cash flow reporting issues – refers to entities' preference to report mainly cash flows from operating activities to create the image of a sustainable company. The financing activities, but especially the extraordinary ones, do not have a repetitive character, for which certain practices are used to classify and transform the specific elements of these activities into receipts and payments related to the operating activity in order to increase the operating cash flow, but without affecting the total reported cash flows.

Other authors (Dechow, Ge & Schrand, 2010), propose the classification of creative accounting techniques into:

✓ accounting options determined by the achievement of the company's objectives and whose use influences investors' decisions;

✓ financial engineers who, in the short term, determine the improvement of some indicators regarding the financial position and performance of the company;

✓ Erroneous accounting classifications that materialize in arbitrary financial reports facilitated by an incomplete accounting legislation that cannot provide a consolidated conceptual framework or answers to the challenges that have arisen as a result of the need to account for some economic transactions that have not been recorded until that moment.

A summary of the most used practices specific to creative accounting is presented in ***Figure 1***:

A short analysis of specialized literature leasds us to the conclusion that the creative accounting practices most often used today aim:

- **fixed assets-through** depreciation (choice of amortization methods and durations), revaluation, acquisition of fixed assets through leasing (lease-back operations), etc.
- **the stocks** - the choice of stock valuation methods upon entry and exit from management, the choice of stock valuation methods
- **determining the financial performance of the entity** - the result of the financial exercise
- **the way assets, liabilities, income and expenses are recognized and evaluated**
- **provisions**- by establishment, increase, decrease or cancellation
- **the fictitious transactions** made in order to manipulate the figures and values from the annual accounts

Figure 1. The Synthetic Approach to the Specific Practices of Creative Accounting
Source: own projection

In our opinion, the classification of creative accounting practices should be as detailed as possible to allow users of the information published in the annual financial statements to discover possible irregularities regarding the presentation of the entity's financial position and performance.

In order to respond to this requirement, following the review of the specialized literature, we have extracted a typology of practices, techniques and methods specific to creative accounting, which we have classified into two large categories:

✍ creative accounting practices, techniques and methods that manipulate the financial position of the economic entity;

✍ Creative accounting practices, techniques and methods that manipulate the financial performance of the economic entity.

2. Literature Review

Naser K., in the work *Creative accounting: its nature and use*, defines creative accounting from an academic perspective as “the process by which, due to the flexibility and existence of gaps in the rules, the figures in the annual accounts are manipulated, the result of the choice of measurement practices and information being the transformation of summary documents from what they should be to what managers want” (Naser, 1993), and points out that “manipulation of accounts is an old accounting problem dating back to the 1920s”. Even though it appeared more than a century ago, creative accounting practices are current, of interest, especially for managers who resort to embellishing accounting earnings to meet the growing expectations of investors regarding of economic returns (Beneish & Nichols, 2005).

Colasse B., in the work *Comptabilité générale*, notes the possibility of the illegality of creative accounting techniques as a result of the diversion of accounting rules:” accounting information practices that are often at the limit of the legal are used by certain entities that take advantage of the limits of regulation and normalization in order to beautifying the image of the financial position and the reported economic performances” (Colasse, 1997).

The opinion expressed by Malo J.L. and Giot H. in the work *L’élasticité du résultat selon les dimensions temps et espace* is also shared by other French authors who come to the defense of creative accounting which they say:”it is virtuous, because it gives accounting the means that allow it to develop at the same pace with financial markets and products”, representing at the same time”certainly a logical and natural evolution in the practice of accounting specialists” (Rybaud-Turillo & Teller, 1997).

In the work *Comptabilité créative*, Stolowy H. refers to creative accounting techniques as a “set of procedures that aim either to modify the result, in the sense of maximizing or minimizing it, or to modify the presentation of the annual financial statements, but without the two objectives being mutually exclusive each other” (Stolowy, 2000), these aspects being a significant part of the theme addressed in this scientific research.

McEnroe J.E. addressed in the study entitled *Individual Investors’ Perceptions Involving the Quality and Usefulness of Audited Financial Statements* the issue of financial scandals caused by the use of creative accounting techniques and highlights the negative effect they had in terms of trust in the reported financial-accounting information (McEnroe, 2007). The analysis of the implications of creative accounting on the quality and usefulness of the information provided by the annual financial statements is defining in the realization of this scientific endeavour.

Beneish M.D., in the work *The Detection of Earnings Manipulation*, identified a number of indicators that can be used to detect the risk of manipulation of the information provided by the annual financial statements. Based on these indicators, the author defined a linear score-type function, using multivariate statistical analysis techniques (Beneish, 1999, pp. 24-36). These analytical models for assessing the risk of embellishment of summary documents were also approached by other authors who integrated the individual and combined effect of the financial indicators of structure, profitability and solvency in score functions in order to identify substantial changes in the position and the entity’s financial performance, an objective that we also set for ourselves within this scientific approach.

In accordance with the subject addressed in this scientific research, we also observe some interest in the national specialized literature, thus the concerns of the last years have been concretized in new writings, perspectives and visions regarding the creative accounting. In contrast to the international specialized literature, however, we notice an insufficiency of publications, studies and works in which this controversial topic is addressed.

The first author who dared to address the subject of creative accounting in our country was the late professor Niculae Feleăgă, who in the work published in 1996, *Accounting controversies, conceptual difficulties and the credibility of accounting* (Feleagă, 1996), talks about the techniques of this type of accounting, as well as the risks that it involves their use in the accounting practice.

Three years later, Liliana Malciu presents in a detailed manner the ideas of her mentor from the work mentioned above, addressing conceptual aspects regarding the motivational complex of 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 this phenomenon (Malciu, 1999). The book *Creative accounting* is interspersed with practical examples that describe the methods of modelling the balance sheet and the profit and loss account and highlight their impact on the financial position and performance of the entity.

The work *Accounting policies and options (Fair Accounting versus Bad Accounting*) written by Feleaga N. and Malciu L. brings into discussion the issue of choosing and developing accounting policies which he divides into two categories: those that aim to achieve honest accounting versus those that are used for handling financial statements (Feleagă & Malciu, 2002). The description of creative accounting techniques is approached in close connection with the negative effects recorded on financial reporting and with the need to define ways to limit and combat them. Another aspect debated by the two authors refers to the analysis of the professional ethics of those who use these practices.

Diaconu P., in the work "*How do accountants make money? Tax evasion, tax havens, creative accounting"* analyzes the role of creative accounting in maximizing the performance of the economic entity (Diaconu, 2004).

Munteanu V. and Zuca M. in the article *Considerations regarding the use of creative accounting in distorting information from financial statements and "maximizing" the company's performance*, consider creative accounting as a tool to support the manager, a tool used to present the desired image of the entity that leads in order to pursue one's own interests (Munteanu & Zuca, 2011)".

In the work *Creative accounting*, Groșanu A. analyzes the relationship between creative accounting and other concepts such as: true image, accounting fraud or corporate governance. It also brings to the fore a series of empirical studies aimed at helping users of the information provided by the annual financial statements in understanding creative accounting techniques and their impact in the Romanian economic environment (Groșanu, 2013, p. 38).

The work: "*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 a positive sense is able to emit an objective truth and message. And yet, let's 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 the fraud risk based on indexes for detection of accounting manipulation (*Robu & Robu, 2013, pp. 3-16) carried out by Robu I.B. and Robu M.A. is based on the model proposed by Beneish (1999) and aims to obtain a score function applicable to

Romanian entities listed on the stock exchange. Thus, the authors had in mind the creation of an econometric model that would allow the classification of these entities into fraud risk groups caused by the manipulation of information from financial reports.

3. Research Methodology

The content of this scientific study pursued the development and deepening of knowledge in the field of creative accounting, the perspective approached being that of fundamental (theoretical) research combined with that of applied research.

We used deductive reasoning to document the researched phenomenon, and among the sources analyzed were: specialized books, articles published in magazines and economic journals indexed in international databases, accounting standards and norms, normative acts. Special attention was paid to the writings in English, French, and Romanian, as the most complex approach to the field under research was pursued. The sources cited throughout the entire paper revealed opinions and analyzes of foreign and domestic authors regarding the phenomenon of creative accounting manifested both at the international and national level and led our steps towards an in-depth, specialized research of the implications they have accounting engineering on the quality of the information provided by the annual financial statements of Romanian economic entities.

The quantitative or positivistic research addressed in the work was embodied in the presentation of some practical peculiarities specific to the field of creative accounting.

In order to carry out the quantitative research, the following methods and techniques were used:

- numerical exemplification, used to present the creative accounting techniques aimed at manipulating the entity’s financial position and performance;
- content analysis of the financial statements published by the studied economic entity;
- comparative and correlative analysis of the results obtained from empirical research;
- Case studies, used to reflect the picture of the financial position and performance obtained by adopting accounting policies with different objectives.

4. Creative Accounting Techniques and Practices Aimed at the Entity's Financial Position

The balance sheet is the summary document that presents the financial position of the economic entity, that are, the assets, liabilities and equity elements existing at the end of a financial year ***(Figure 2).***

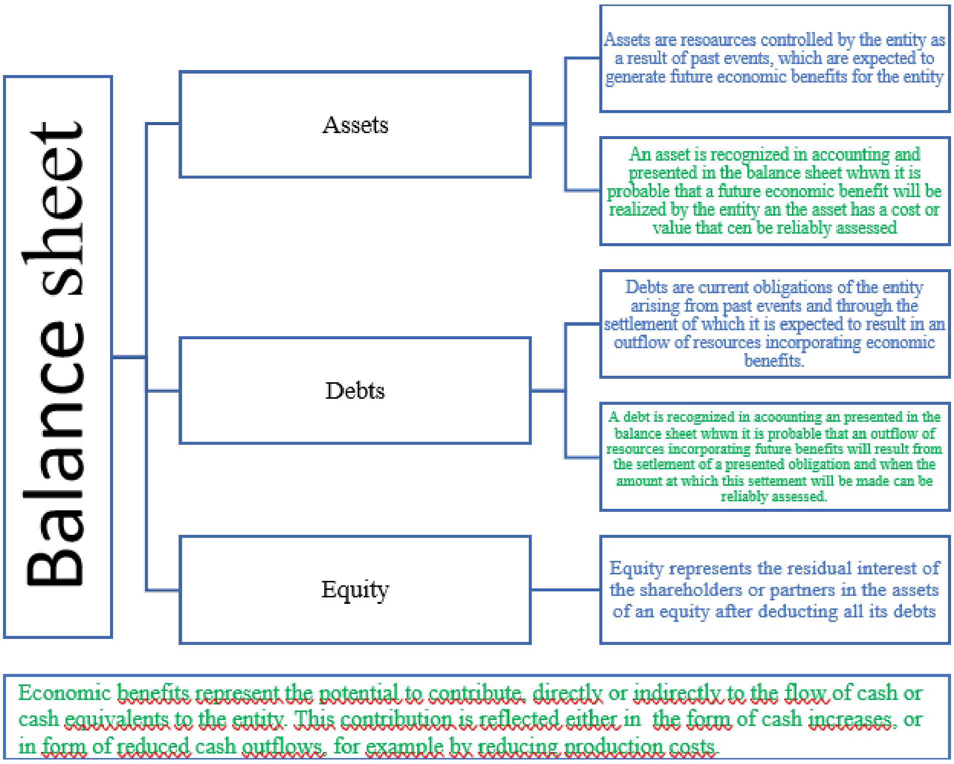

Figure 2. Elements of the Balance Sheet

Source: Gurău M., Gurău M.I., (2020), Accounting in the era of the digital economy. Accounting policies and procedures, Publishing House of the University of Bucharest, pp. 50-51.

The importance of the balance sheet is recognized because this document presents information of public interest regarding the economic and financial situation of the enterprise. As a result, the creative accounting techniques used in order to "beautify" the elements of the balance sheet have real consequences on the presentation of the *financial position of the entity*, consequences embodied in: "beautifying" equity capital, reducing the degree of indebtedness, "improving" the level of working capital or treasury.

Next, we consider that a detailed analysis of practices, techniques and methods that influence, manipulate and distort the financial position of the economic entity ***(Table 1)*** is required.

Table 1. The Influence of Creative Accounting on the Entity's Financial Position

Targeted items	Action mechanisms (practices, techniques and methods)	Impact on the financial position	Limits	The nature of the mechanism
Fixed assets	Lease-back operations (selling a long-term asset and leasing the same asset)	Improving the working capital and the treasury	The artificial improvement of the financial position	Financial mechanism
Fixed assets and equity	Revaluation of the tangible assets	Increasing the value of assets and own capital	Imposing the reevaluation	Financial mechanism
Equity	The issue of hybrid securities whose classification between equity and debt is difficult	Change in debt ratio and return of equity	The clear distiction between equity and debt should determine a better classification of hybrid instruments	Financial mechanism with accounting objective
Minority interests	Inclusion in equity, in debt in both or finding another solution	Change in debt ratio and return of equity		Options
Loans	Delevaranging, in fact, the economic cancellation of a debt, an option by which the company transfers a debt (and assets) to a structure that must repay it	Reducing the degree of indebtedness, increasing the rate of financial profitability and the rate of financial autonomy	Irrecocable transfer of debt	Financial mechanism
Customer receivables	Discounting a promissory note	Reducing the need for working capital and increasing the treasury (accounting point of view)	The need for working capital is not diminished, and the treasury does not increase (from a financial point of view)	Financial mechanism
	Assigment of receivables to a common receivables fund in order to obtain liquidity	The slight decrease in working capital caused by the difference between the amount of the claim am the transfer price, the decrease in the need for working capital and the increase in the treasury		Financial mechanism
	Mobilizing receivables to guarantee loans granted througv the assignment of professional debts	The debt ratio increases, but no changes are recorded in working capital, the need for working capital or the treasury		Financial mechanism

Source: author processing

5. Creative Accounting Techniques and Practices Aimed at Entity's Financial Performance

The profit and loss account is the synthetic document that presents the *financial performance* of the economic entity, by reporting the income and expenses of a financial year ***(Figure no.3)***:

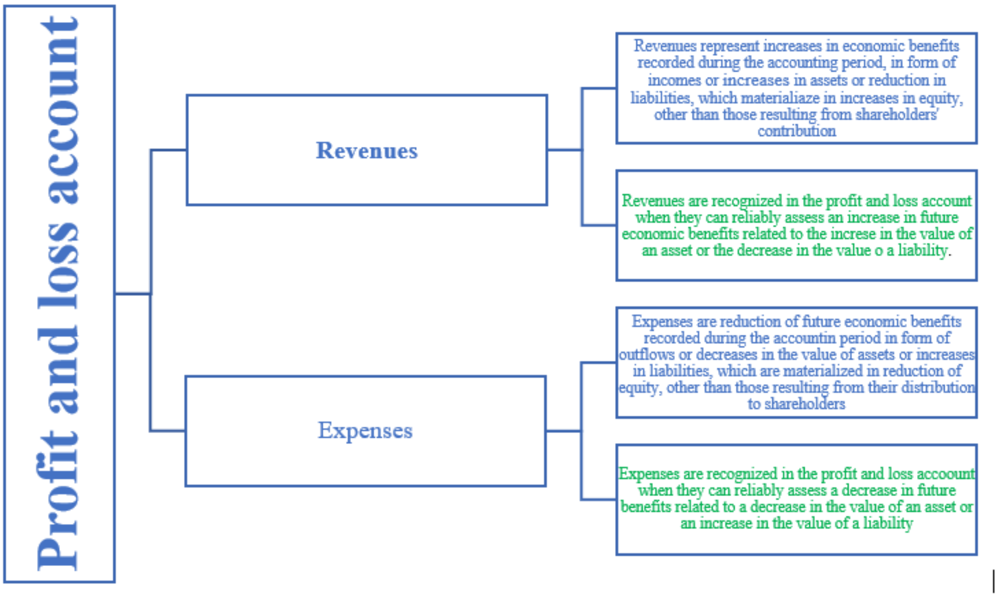

Figure 3. The Elements of the Profit and Loss Account
Source: Gurău M., Gurău M.I., (2020), Accounting in the era of the digital economy. Accounting policies and procedures, Publishing House of the University of Bucharest, pp. 53-54.

One of the stakes of creative accounting, perhaps the most important, is the modification of the results, the financial performances of the entity. The specialized literature proposes an expression for these changes: the management of the results (***Figure no.4***).

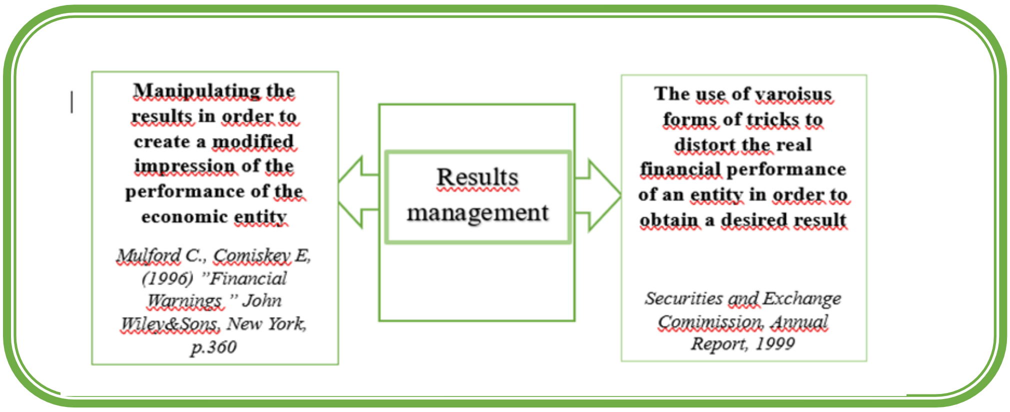

Figure 4. Result Management - Definition of the Concept
Source: own projection

The accounting creativity affects the reporting of the financial performance of the entity in the sense of presenting increased or artificially reduced results. Depending on the interests pursued by the management of the entity, the creative accounting techniques and the consequences of using their profit and loss account are detailed in ***Table 2***:

Table 2. The Influence of Creative Accounting on the Financial Performance of the Entity

Targeted items	Action mechanisms (practices, techniques and methods)	Impact on the financial position	Limits	The nature of the mechanism
Fixed assets	Lease-back operations (selling a long term asset and leasing the same asset)	Reacording in the results of a capital gain in the year of sale, rents are recorded throughout the leasing contract	The artificial improvement of the financial performance as a result of a commitment to pay the rent during the leasing period. The risk of fictious dividents.	Financial mechanism
	Analysis of assets in order to determine depreciation	The reduction of the result in the case that the asset has suffered depreciation		Option Professional reasoning
Depreciation	The choice of depreciation methods, the duration of use, the estimation of the residual value	Change in depreciation expenses	The need for a depreciation designed in compliance with the principle of permanent methods	Option Professional reasoning
The goodwill	Capitalization of goodwill or imputation of goodwill on equity	Modification of expenses with depreciation of the goodwill		Option Professional reasoning
Research and development expenses	Capitalization of research and development expenses	Increase in the result in the year of capitalization. Decrease in the result in the year of the transfer and in the following years due to depreciation.	Fulfillment of the conditions stipulated in the reporting rules; difficulties in evaluating the cost of research.	Option Assessment
Stocks	Incorporation of financial expenses in the production cost of stocks	The increase in the result in the year of incorporation of expenses, respectively its decrease in the year of stock reduction.	Difficulties in defining borrowed capital and production financing. The presentation in the annexes of the value of the expenses and the justification of the capitalization.	Option Assessment
	Different methods of stocks valuation at exit	Modification of the result depending on the chosen method	The principle of permanent methods	Option Assessment
	Inclusion/exclusion of some expenses in the purchase cost	Increase/decrease the result	The principle of prudence	Option Assessment
	Increase/decrease stocks of finished products	Increase/decrease the result	The principle of prudence	Option Assessment
Construction contracts	Choosing the accounting method	The method of the percentage of advancement determines the increase of the result. The method of finishing the works determines the decrease of the result.	The principle of permanent methods	Option Professional reasoning
Interest expenses	Capitalization of interest expenses	Increasing the result. If interest expenses are recognized, the result is reduced.	Fulfilling the conditions of the rules.	Option Assessment

Provisions for risks and expenses	Creation/cancellation of provisions (increase/decrease provisions)	Decrease in the result following the creation or increase of provisions; increasing the result following the cancellation or reduction of provisions.	The principle of prudence	Option Assessment
Adjustments for the depreciation of participation titles	Undervaluation/overvaluation of depreciation on participation titles	Modification of the result in the year of registration	The principle of prudence	Option Assessment
Adjustments for depreciation of current assets	Undervaluation/overvaluation of receivables and stocks	Modification of the result in the year of registration	The principle of prudence	Option Assessment

Source: author processing

6. Impact of Creative Accounting Techniques on the Balance Sheet and the Profit and Loss Account

The techniques and practices of creative accounting are accounting tools whose purpose is to manipulate the financial statements of the entity. With the help of these techniques, the accounting professional uses his imagination, experience and reasoning to present the information from the annual accounts in a favourable way to the company he operates.

The impact of accounting creativity on the balance sheet and the profit and loss account is materialized in changing the position and financial performance of the entity. Even if we presented in the tables previously made the correlation between the creative accounting techniques and their impact on the financial statements, we consider that some details and comments are required:

- the temptation of the producers of financial-accounting information to use the creative accounting techniques is higher if the performance manipulation is pursued to the detriment of the financial position;

- The balance sheet has the role of providing the information that allows the issuance of value judgments regarding the yield and risk related to the economic entity, as well as the assessment of future cash flows. In this sense, the techniques of creative accounting aim to improve the structure of the balance sheet, through actions allowed by norms on own equity, debt or cash;

- The handling of the profit and loss account follows the presentation of desired, not real financial performance. In most cases, the entity aims to increase the results presented, but sometimes, depending on the objectives set by the management, it is desired to obtain a diminished result.

All these represent consequences of using creative accounting techniques and are presented, synthetic, in ***Figure 5***:

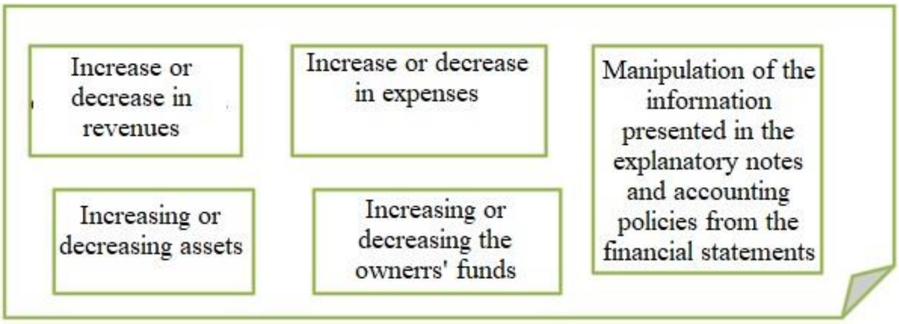

Figure 5. The Consequences of Using Creative Accounting Techniques
Source: own projection

The specialized literature analyzes the effects of using creative accounting techniques on financial statements and draws attention to how they affect the decisions of users of accounting information. For example, the change in income and expenses determines the change in the result (consequence on the profit and loss account), but also in the reserves (consequence on the accounting balance sheet), so the beneficiaries of the accounting statements make decisions according to the new value of equity and all calculated rates based on it. But identifying creatively prepared financial statements is difficult because of the multiple implications that creative accounting techniques have on the elements underlying the determination and presentation of the entity's financial position and performance.

Another aspect studied by specialized literature refers to the creative way of presenting (communication) of the financial-accounting information: positive discrimination and persuasive language (Vladu, Groșanu & Cuzdriorean, 2012, pp. 105-111).

Figure 6 highlights the creativity of economic entities in terms of communicating the information provided by the financial statements.

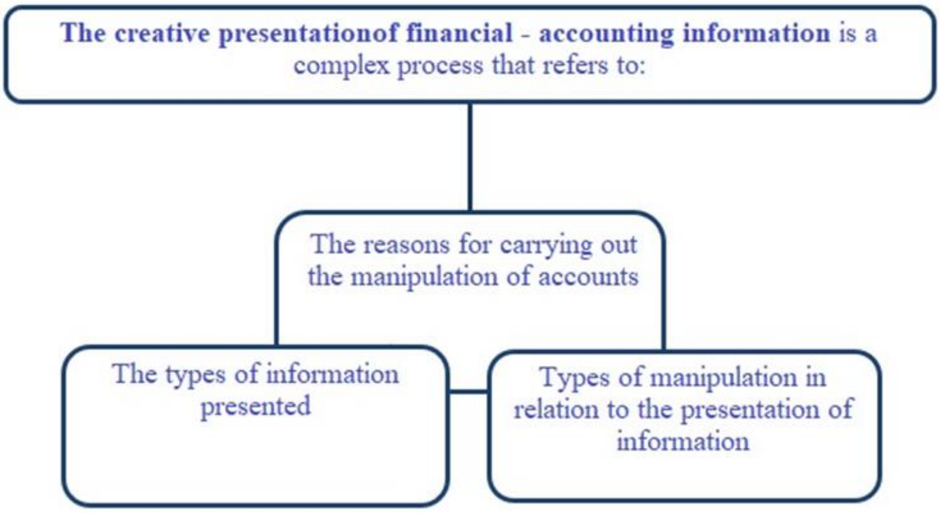

Figure 6. Creative Presentation of the Financial-Accounting Information
Source: own projection

Persuasive language refers to the frequent use of positive phrases to describe the financial performance of the economic entity, in other words the way the information is presented is more important than the information itself. This type of manipulation is called" positive discrimination" (Lang & Lundholm, 2000, pp. 623-662) in the specialized literature.

The impact of positive discrimination and persuasive language as a technique of creative accounting must be evaluated from the perspective of the user of financial accounting information involved in the decision-making process. The studies carried out so far divided the researchers into two categories: one category includes those who invalidate the relationship between positive discrimination and the perception of information users (Stanton P., Stanton J., Pires G., (2004), and the other category includes those who concluded that the creative presentation of financial-accounting information can affect investment decisions.

Considering that investors base their decisions on the information provided by annual financial statements (Wills, 2008) and that some users do not have advanced accounting knowledge or the necessary experience, we agree that the technique of using persuasive language in the presentation of financial-accounting information has an impact on the decision-making process.

In order to demonstrate that the creative presentation of financial-accounting information aims to influence the attitude, opinions and behaviour of users (Jones, 1996, p. 86), we present below a fragment of the Enron company's letter to its shareholders from the year 2000 ***(Figure 7).*** About Enron we can say that it is the most publicized bankruptcy in US history, bankruptcy caused by the use of creative accounting techniques and declared in 2001.

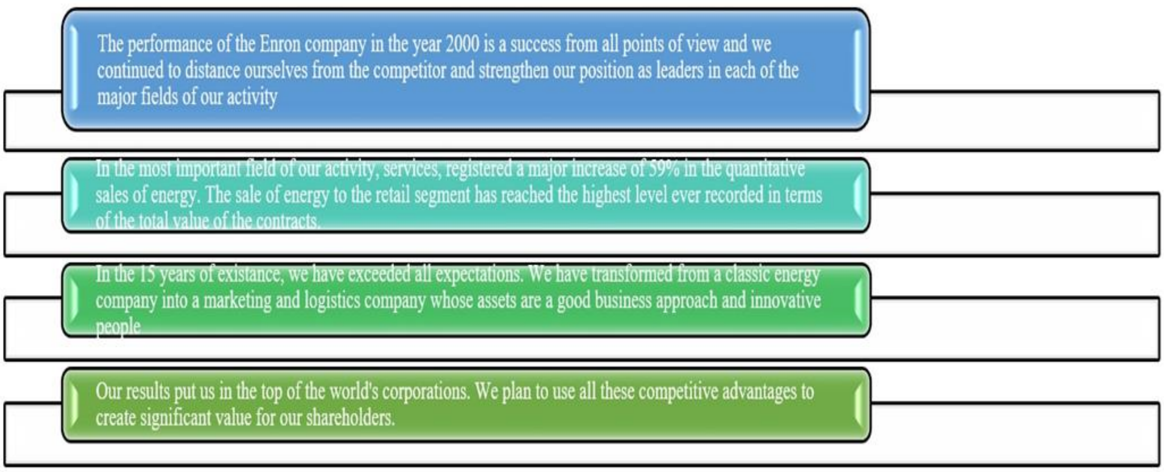

Figure 7. The Persuasive Language Used by the Enron Company in its Letter to its Shareholders
Source: Groşanu A., (2013), Creative Accounting, Postdoctoral Advanced Research Collection in Economic Sciences, ASE Publishing House, Bucharest.

Positive discrimination and persuasive language influence the quality of information provided by financial statements because it aims to distract users from the numbers in the reports and maximize the importance of the"nice words" that describe the entity's performance (Clatworthy & Jones, 2001, pp. 311-326).

In conclusion, the impact of the use of creative accounting techniques on the balance sheet and the profit and loss account is significant because these techniques aim to create an "improved" image of the economic entity, a fact that misleads users of financial-accounting information.

7. Empirical Studies of the Application of Creative Accounting Techniques and Practices

Creative accounting influences the financial position and performance of the economic entity, but also the decisions of the users of the financial-accounting information. The theoretical analysis of the impact of the techniques and practices specific to creative accounting on the financial statements has already been carried out previously. However, we also consider it necessary to analyze from a practical perspective, through empirical studies, the main creative accounting techniques that can be used at the level of economic entities, because in this way we can better understand their influences on the figures presented in the annual accounts.

7.1. Creative Accounting Techniques for Research and Development Expenses

An economic entity starts a research and development project carried out during two financial years. The expenses generated by this project amount to 6,400 lei in year 1, respectively 9,600 lei in year 2. The project generates income in the next 2 years in the amount of 11,200 lei/year. The total revenues recorded by the entity, less those generated by the research and development project, amount to 32,000 lei.

Possible accounting treatments:

Option A: the entity capitalizes research and development expenses in the years in which they were incurred and records their depreciation in the years in which the project generated income.

Option B: the entity capitalizes the research and development expenses in the first year and, as a result of some uncertainties regarding the completion of the project, decides to transfer these expenses to the profit and loss account in the 2nd year.

Option C: the entity classifies the expenses generated by the project in the "research" category.

Within ***Table 3*** presents the influence of alternative treatments regarding research and development expenses on the profit and loss account and we interpret the results obtained in order to issue relevant conclusions regarding the options chosen by the entity.

Table 3. The Influence of Research and Development Expenses on the Profit and Loss Account

		Year 1	Year 2	Year 3	Year 4	Total
Option A	Total revenues	32,000	32,000	32,000	32.000	128.000
	Revenues from the production of intangible assets	6,400	9,600	0	0	16,000
	Revenues generated by the project	0	0	11,200	11,200	22,400
	Expenses (less depreciation)	(6,400)	(9,600)	0	0	(16,000)
	Depreciation expenses	0	0	(8,000)	(8,000)	(16,000)
	Accounting result	**32,000**	**32,000**	**35,200**	**35,200**	**134,400**
Option B	Total revenues	32,000	32,000	32,000	32,000	128,000
	Revenues from the production of intangible assets	6,400	0	0	0	6,400
	Revenues generated by the project	0	0	11,200	11,200	22,400
	Expenses (less depreciation)	(6,400)	(16,000)	0	0	(22,400)
	Depreciation expenses	0	0	0	0	0
	Accounting result	**32,000**	**16,000**	**43,200**	**43,200**	**134,400**
Option C	Total revenues	32,000	32,000	32,000	32,000	128,000
	Revenues from the production of intangible assets	0	0	0	0	0
	Revenues generated by the project	0	0	11,200	11,200	22,400
	Expenses (less depreciation)	(6,400)	(9,600)	0	0	(16,000)
	Depreciation expenses	0	0	0	0	0
	Accounting result	**25,600**	**22,400**	**43,200**	**43,200**	**134,400**
Interpretation of the results: it can be seen that the total accounting result is the same, but the structure within each year differs, depending on the option chosen Creative accounting techniques related to research and development expenses are related to capitalize or not the expenses, the value of capitalized expenses and their depreciation policy. Also, the distinction between development and research expenses creates premises for the manifestation of accounting creativity: the use of a capitalization policy of research and development expenses increases or decreases the accounting result of a financial exercise by simply classifying them in the reserach category (the profit and loss account is affected) or in the development category (the balance sheet is affected)						

Source: design and processing by author

7.2. Creative Accounting Techniques Regarding Establishment Expenses

An economic entity issues 2,500 new shares in order to increase the social capital by the amount of 25,000 lei. The issue price is 12 lei/share. The issue of the new shares generated expenses in the amount of 1,000 lei + 19% VAT. The entity registers revenues from sales of 12,500 lei/year.

Possible accounting treatments:

Option A: the entity capitalizes the establishment expenses and records their depreciation over 2 years.

Option B: the entity capitalizes the establishment expenses and covers them from the issue premium.

Option C: the entity recognizes the establishment expenses directly in the profit and loss account.

In ***Table 4*** presents the influence of different accounting treatments regarding the establishment expenses on the profit and loss account and we interpret the results obtained in order to issue relevant conclusions regarding the options chosen by the entity.

Table 4. The Influence of Establishment Expenses on the Profit and Loss Account

		Year 1	Year 2	Total
Option A	Turnover	12,500	12,500	25,000
	Expenses (less depreciasion)	0	0	0
	Depreciation expenses	(500)	(500)	(1,000)
	Accounting result	**12,000**	**12,000**	**24,000**
Option B	Turnover	12,500	12,500	25,000
	Expenses (less depreciasion)	0	0	0
	Depreciation expenses	0	0	0
	Accounting result	**12,500**	**12,500**	**25,000**
Option C	Turnover	12,500	12,500	25,000
	Expenses (less depreciasion)	(1,000)	0	(1,000)
	Depreciation expenses	0	0	0
	Accounting result	**11,500**	**12,500**	**24,000**

Interpretation of the results: it can be seen that the total accounting result is the same for options A and C, but the structure of this result is different. If the entity chooses option B, the total accounting result is different because de expenses for issuing rhe new shares are coverd directly from the capital premium.
The creative accountin techniques related to the establishment expenses refer tot hei knowledge in the financial statements, their depreciation method an their depreciation period.

Source: design and processing by author

7.3. Creative Accounting Techniques Regarding Tangible Assets (Depreciation Policy)

Economic entities A and B operate in the same field and register identical indicators: turnover = 48,000 lei/year, expenses related to turnover (less depreciation) = 28,800 lei/year.

Both entities purchase a machine worth 17,280 lei.

Possible accounting treatments:

Situation I: entity A depreciates the machinery over 2 years, unlike entity B which depreciates the machinery over 3 years. Both entities use the straight-line depreciation method.

Situation II: entity A uses the straight-line depreciation method, unlike entity B which uses the accelerated depreciation method. Both entities depreciate the equipment in 3 years.

Within ***Table 5*** shows how the depreciation period of fixed assets influences the financial performance of the economic entity and we interpret the results obtained to understand the information provided in the profit and loss account.

Table 5. The influence of the depreciation period on the profit and loss account (Situation I) (Stancu, 1997, p. 469)

		Year 1	Year 2	Year 3	Total
Entity A	Turnover	48,000	48,000	48,000	144,000
	Expenses related to turnover	(28,800)	(28,800)	(28,800)	(86,400)
	Depreciation expenses	(8,640)	(8,640)	0	(17,280)
	The result of exploitation	**10,560**	**10,560**	**19,200**	**40,320**
Entity B	Turnover	48,000	48,000	48,000	144,000
	Expenses related to turnover	(28,800)	(28,800)	(28,800)	(86,400)
	Depreciation expenses	(5,760)	(5,760)	(5,760)	(5,760)
	The result of exploitation	**13,440**	**13,440**	**13,440**	**40,320**

Interpretation of the results: entities A and B have identical final performances because they have the sama capitals an duse them under the same conditions. However, entity A improves its result in year 3, giving the impression of a more performing entity. To avoid this trap the users of the accounting information must ensure that the depreciation periods of the two entities are comparable or they can calculate the gross operating surplus EBE, an indicator that does not take into account the depreciation and provisions policy chosen by the entity. In this case, the EBE is the same in each of the third years, namely 19,200 lei, which indicates that the two entities register the same financial performance.

The gross operating surplus expresses the gross accumulation from the operating activity and, therefore, the potential capacity for self-financing of investments, payment of debts to the state and remuneration of capital investors (shareholders and creditors)

Source: design and processing by author

Within ***Table 6*** presents how the method of depreciation of fixed assets influences the financial performance of the economic entity and we interpret the results obtained to understand the information provided in the profit and loss account.

Table 6. Influence of the Depreciation Method on the Profit and Loss Account (Situation II)

		Year 1	Year 2	Year 3	Total
Entity A	Turnover	48,000	48,000	48,000	144,000
	Expenses related to turnover	(28,800)	(28,800)	(28,800)	(86,400)
	Depreciation expenses	(5,760)	(5,760)	(5,760)	(17,280)
	The result of exploitation	**13,440**	**13,440**	**13,440**	**40,320**
Entity B	Turnover	48,000	48,000	48,000	144,000
	Expenses related to turnover	(28,800)	(28,800)	(28,800)	(86,400)
	Depreciation expenses	(8,640)	(4,320)	(5,760)	(17,280)
	The result of exploitation	**10,560**	**14,880**	**14,880**	**40,320**

Interpretation of the results: Entities A and B have identical final performances because they have the same capitals and use them under the same conditions. However, entity B improves its results in year 2 and 3, giving the impression of a better performing entity. To avoid this trap, users of accounting information must ensure that the depreciation methods of the two entities are comparable. Also, in order to be able to compare the real performances of the two entities, the calculation of the gross operating surplus is indicated.

Source: design and processing by author

7.4. Creative Accounting Techniques for Inventories (Subactivity Cost Accounting)

An economic entity annually produces 132,000 pieces of product X, the average monthly production being 11,000 pieces. For the production of a piece of product X, the entity registers raw material expenses in the amount of 110 lei and labour expenses in the amount of 66 lei. The annual depreciation expenses amount to 990,000 lei. We consider the monthly turnover constant, in the amount of 2,750,000 lei. In the first 11 months of the year, the production obtained is sold in full, but in December the entity has no orders from customers.

Possible accounting treatments:

Option A: the entity decides that in December it will continue to carry out the established production, even if there are no orders for product X.

Option B: the entity decides to stop production in December and to send the staff who will receive only 75% of their salary into technical unemployment.

In ***Table 7*** presents how the cost of the subactivity influences the financial performance of the economic entity and we interpret the results obtained to understand the changes appearing in the profit and loss account.

Table 7. Influence of Subactivity Cost on the Profit and Loss Account

	Option A	**Option B**
Turnover	30,250,000	30,250,000
Expenses related to turnover	2,018,500	0
Material expenses	(14,520,000)	(13,310,000)
Salary Expenses	(8,712,000)	(8,530,500)
Depreciation expenses	(990,000)	(990,000)
The result of exploitation	**8,046,500**	**7,419,500**
Inter*pretation of the results: Choosing option A allows the entity to hide the costs of sub-activity and to obtain a better result than in the case of choosing option B. But there is a risk that the market will not accept these products obtained without a firm order as a basis and, for this reason, the entity may register a loss in the following period.* Subactivity cost accounting can be another way of showing accounting creativity. The decision to produce goods, even when there are no orders for the respective production, can allow an entity to improve its result because the fixed expenses are incorporated into the cost of production and are not settled directly on the accounting result.		

Source: design and processing by author

7.5. Creative Accounting Techniques Regarding Construction Contracts

A construction contract worth 1,250,000 lei must be completed in 2 years, and its execution involves estimated total expenses of 1,000,000 lei. In the first year, actual expenses in the amount of 562,500 lei are recorded, and in the following year expenses in the amount of 500,000 lei are estimated. The total value of the construction contract has not been revised. In the second year of the contract, actual expenses in the amount of 487,500 lei are recorded, and the construction is completed. We specify that no advances were invoiced or collected during the contract period.

Possible accounting treatments:

Option A: the entity uses the percentage of progress method as the construction contract accounting method.

Option B: the entity uses the method of completion of works, as the method of accounting for the construction contract.

Through ***Table 8*** presents the influence of construction contract accounting methods on the profit and loss account and we interpret the results obtained in order to issue relevant conclusions regarding the options chosen by the entity.

Table 8. The Influence of the Construction Contract Accounting Method on the Profit and Loss Account

		Year 1	Year 2	Total
Option A	Revenues from works and services	703,125	546,875	1,250,000
	Revenues related to the costs of production in progress	0	0	0
	Exploitation expenses	(562,500)	(487,500)	(1,050,000)
	The result of exploitation	**140,625**	**59,375**	**200,000**
Option B	Revenues from works and services	0	1,250,000	1,250,000
	Revenues related to the costs of production in progress	562,500	(562,500)	0
	Exploitation expenses	(562,500)	(487,500)	(1,050,000)
	The result of exploitation	**0**	**0**	**200,000**
Interpretation of the results: Choosing option A allows the entity to divide the accounting result in the two years of the contract, depending on the percentage of work execution. In the case of choosing option B, the result is recognized only at the end of the construction works.				

Source: design and processing by author

7.6. Creative Accounting Techniques on Receivables

An economic entity has a claim in the amount of 4,950 lei for which there is a risk of non-payment. Under these conditions, the entity insures the claim against the amount of 1,320 lei. Other data: turnover = 82,500 lei; expenses related to turnover = 57,750 lei.

Possible accounting treatments:

Option A: the entity records adjustments for impairment.

Option B: the entity insures the claim.

In ***Table 9*** presents the influence of doubtful debts on the financial performance of the economic entity and we interpret the results obtained to understand the changes appearing in the profit and loss account.

Table 9. The Influence of Doubtful Debts on the Profit and Loss AccouNT

	Option A	Option B
Turnover	82,500	82,500
Expenses related to turnover	(57,750)	(57,750)
Insurance premium expenses	0	(1,320)
Expenses with adjustments for depreciation	(4,950)	0
The result of exploitation	**19,800**	**23,430**
Interpretation of the results: underwriting an insurance allows to improve the result with the difference between the value of the depreciation of the claim (4,950 lei) and the insurance premium paid (1,320 lei) If the economic entity appreciates that there is a risk of non-collection of some receivables, it can proceed to insure them. In this way, it is no longer necessary to create an adjustment for the depreciation of the receivable.		

Source: design and processing by author

7.7. Creative Accounting Techniques Regarding Provisions

An economic entity registers in year N sales revenues of 25,000 lei and expenses related to the turnover in the amount of 15,000 lei. The forecast for the coming years is bleak, with sales expected to decline. In this context, the entity decides to establish a provision for risks and expenses in year N in the amount of 5,000 lei. In year N+1, the risk is reduced, which causes expenses of 1,250 lei. Turnover (N+1) = 17,500 lei, related expenses CA (N+1) = 12,500 lei.

Possible accounting treatments:

Option A: the entity constitutes the provision for risks and expenses in the amount of 5,000 lei

Option B: the entity constitutes a provision for risks and expenses of a lower value (2,500 lei) depending on the estimate of a maximum accepted amount.

In ***Table 10*** presents the influence of the provisions policy on the profit and loss account and we interpret the results obtained to determine how the chosen policy changes the financial performance of the entity.

Table 10. The influence of provisions policy on the profit and loss account

<table>
<tr><th colspan="2"></th><th>Year N</th><th>Year N+1</th><th>Total</th></tr>
<tr><td rowspan="6">Option A</td><td>Turnover</td><td>25,000</td><td>17,500</td><td>42,500</td></tr>
<tr><td>Revenues from provitions</td><td>0</td><td>5,000</td><td>5,000</td></tr>
<tr><td>Expenses related to turnover</td><td>(15,000)</td><td>(12,500)</td><td>(27,500)</td></tr>
<tr><td>Other operating expenses</td><td>0</td><td>(1,250)</td><td>(1,250)</td></tr>
<tr><td>Provisions expenses</td><td>(5,000)</td><td>0</td><td>(5,000)</td></tr>
<tr><td>The result of exploitation</td><td>5,000</td><td>8,750</td><td>13,750</td></tr>
<tr><td rowspan="6">Option B</td><td>Turnover</td><td>25,000</td><td>17,500</td><td>42,500</td></tr>
<tr><td>Revenues from provitions</td><td>0</td><td>2,500</td><td>2,500</td></tr>
<tr><td>Expenses related to turnover</td><td>(15,000)</td><td>(12,500)</td><td>(27,500)</td></tr>
<tr><td>Other operating expenses</td><td>0</td><td>(1,250)</td><td>(1,250)</td></tr>
<tr><td>Provisions expenses</td><td>(2,500)</td><td>0</td><td>(2,500)</td></tr>
<tr><td>The result of exploitation</td><td>7,500</td><td>6,250</td><td>13,750</td></tr>
<tr><td colspan="5">Interpretation of the results: Choosing option A gives the entity the possibility of presenting an increasing result, but the estimate made proved exaggerated because the risk was much lower. In the case of choosing option B, the result decreases in year N+1 compared to year N, a fact that affects the entity and its investors.
Provisions are used to cover risks, expenses or losses that are uncertain either in terms of their size or in terms of when they will be realized.
They occupy an intermediate position between equity and debt. Requiring estimates, provisions create conditions for changing the results.</td></tr>
</table>

Source: design and processing by author

8. Conclusions

Creative accounting uses a wide range of techniques and practices through which economic entities can change their image of financial position and performance. To this end, elements of the balance sheet and the profit and loss account are distorted and presented to users of financial-accounting information. The impact of these techniques is revealed by a series of case studies in Part II of this study and refers to increases/ decreases of income and expenses with effect on the result of the exercise, as well as changes in value and structure of assets, debts and capital with effect on the financial position of the entity.

The implications of creative accounting on annual accounts involve a series of risks assumed by the entity management, risks that can be diminished by implementing strategies for detecting and limiting the mechanisms for manipulating financial-accounting information. However, this is difficult to achieve, if we take into account the fact that managers are largely in agreement with the use of creative accounting, acting at the shelter of its legality.

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