ACCOUNTING POLICIES – A SOURCE OF INSPIRATION FOR CREATIVE ACCOUNTING

Ph.D. Student Ana-Maria COMÂNDARU (ANDREI)
"Valahia" University of Targoviste, Romania
E-mail: annyys13@yahoo.com

Abstract: *The choice and application of accounting policies by the economic entity is a flexible process based on the reasoning of professional accountants. This flexibility leads to the reporting of different results obtained by entities in similar or identical situations. Thus, a possible manipulation of the financial statements appears, with direct consequences on the decisions taken by the users of the financial-accounting information. In this scientific approach, I intend to analyze the impact of the accounting policies and options chosen by the entity on the financial statements. The research undertaken is based on a review of the literature and legislation in force, as well as on an empirical study that will help me to draw relevant conclusions.*

Keywords: *accounting policies, options, accounting innovation, manipulation of financial results, creative accounting.*
JEL Classification: *M41.*

1. Introduction

Accounting is a tool for knowing and managing financial position, performance and changing financial position (Gurău and Gurău, 2020, p. 85). The role of accounting is to ensure the provision of financial-accounting information necessary for different categories of users to make the best economic decisions. But the existence of multiple economic uncertainties in which an entity operates makes many elements of financial results impossible to measure with certainty, they are only estimated. In this context, managers use the development and application of accounting policies specific to the entity and its object of activity.

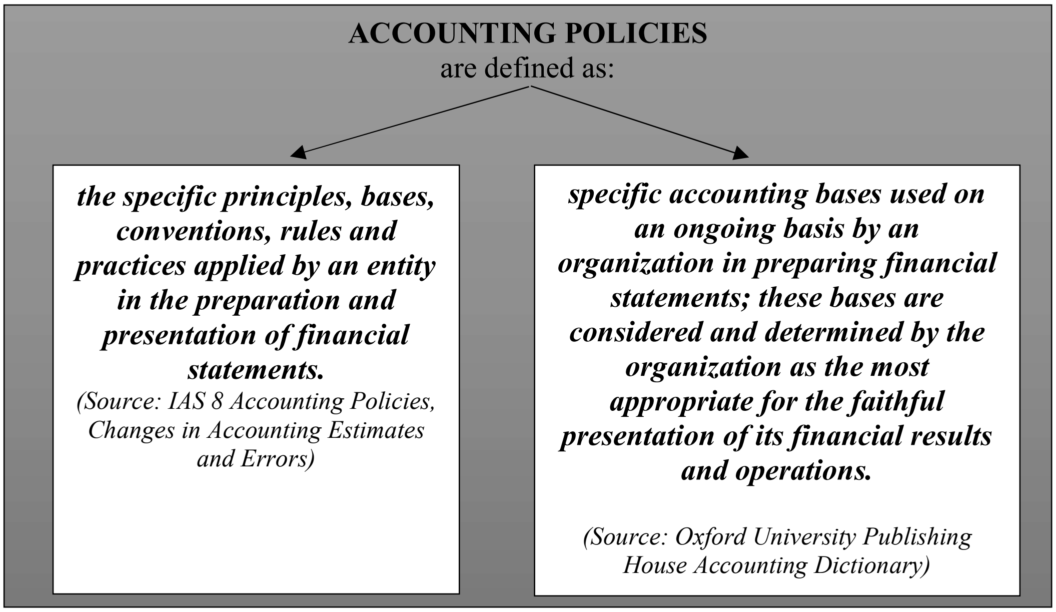
The elaboration by the management of the economic entity of some more and more innovative derivative procedures that lead to a "change of surface" of the financial results is found in the specialized literature under the name of creative accounting. Since its inception in the Anglo-Saxon system, accounting creativity has proven to be virtuous as it provides accounting with the means to enable it to keep pace with the ever-increasing development of markets and the proliferation of financial results. But while accounting innovation is needed to keep up with economic, legal and social developments, the problem arises when the instinctive perversion of business people begins to manifest itself.

Accounting policies are options determined by certain interests, in compliance with certain principles, rules and conventions on the registration, recognition and measurement of items described by the accounting model, preparation and presentation of financial statements (Ristea and Dumitru, 2012, p. 32).

2. Review of the specialized literature and the legislation in force

The literature provides numerous definitions of the concept of accounting policies, all referring to the steps taken by an entity to report honest accounting, based on a true and fair view. In order to understand what is meant by the phrase "accounting policies", the figure below presents two definitions, in my opinion the most relevant.

Figure no. 1. Defining accounting policies



Source: own projection

Romanian legislation, in this case OMFP no. 1802/2014[1], took over the definition given to the accounting policies by the international accounting standards (IAS 8), adding also the obligation to develop its own accounting policies, with the specification that they are approved by the entity's administrator. The same national regulations state that: “In the notes to the financial statements, all entities shall disclose, in addition to the information required by other provisions of these regulations, information on the following:

a) the accounting policies adopted, including:

- the evaluation bases applied to the different elements;
- compliance of the adopted accounting policies with the accounting principles provided by the present regulations;
- any significant changes in the accounting policies adopted; (…)”[2]

The application of accounting policies and the obligation to draw up an accounting policy manual have direct consequences on the financial statements, including on the indicators calculated on the basis of the information provided by the annual accounts; that is why the legislator allocates a more and more comprehensive space to the argumentation of the choice of accounting policies in the explanatory notes of the financial statements.

At the same time, the local legislation presents a series of accounting policies aimed at choosing certain treatments to the detriment of others. The following figure lists these examples of accounting policies.

[1] OMFP no. 1802/2014 for the approval of the Accounting Regulations regarding the individual annual financial statements and the consolidated annual financial statements.

[2] Practical guide for the application of the accounting regulations regarding the individual annual financial statements and the consolidated annual financial statements approved by OMFP no. 1802/2014, 2015, CECCAR Publishing House, Bucharest, pp. 24.

Figure no. 2. Examples of accounting policies

* choosing the method of depreciation of fixed assets
* revaluation of tangible assets or preservation of their historical cost
* the recording during the period in which the tangible assets are conserved, of an expense with depreciation or of an expense corresponding to the adjustment for the depreciation found
* choosing a stock valuation method
*inventory accounting through permanent or intermittent inventory

Source: OMFP no. 1802/2014

The choice and elaboration of these accounting treatments is made according to the specific activity of the economic entity and the strategy adopted by it. The objectives of accounting policies differ from one entity to another, but each pursues essentially the same thing: reducing reported losses, reducing taxable profits, increasing results to attract new investors, steady or relatively stable financial performance necessary to reduce the financial risk felt by the business environment.

It is very important that, once the accounting policies for choosing the most appropriate treatment for the entity have been established, they are kept for as long as possible. The obligation to argue the chosen accounting policies in the explanatory notes to the financial statements has the expected effect of increasing the confidence of users of accounting information.

The consistency and permanence of accounting policies that are considered appropriate for the enterprise at a given time must become a management goal, even if at present the accounting treatment considered favorable to the entity no longer offers the same satisfaction.

- The legislator allows changes in accounting policies, but it must be borne in mind that any change in methods leads to different effects. Following the provisions of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, three cases are identified in which changes in accounting policies are approved, namely:
  - if they are required by law;
  - if they are required by an accounting standard;
  - whether they result in more relevant or credible information on the company's financial policy and performance (Ristea and Dumitru, 2012, p. 39).

The legal regulations also stipulate that any changes in accounting policies must appear in the explanatory notes to the financial statements.

Analyzing the international and national accounting standards, there is a certain flexibility given by the possibility of choosing some accounting treatments to the detriment of others. To limit this freedom, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* lays down the following rules:

- if there is a standard that specifically applies to a transaction, event or condition, then the accounting treatment must be chosen in accordance with the regulations of that standard;

- in the absence of a standard that specifically applies to a transaction, event or condition, professional judgment will be used to determine the most appropriate accounting policies for the company.

The Romanian legislator also called for the imposition of limits on the choice of accounting methods used by entities, stating that the accounting policies approved by administrators must comply with applicable law, both in the field of accounting and legislation in general. In developing accounting policies must compliance with the accounting principles set out in the regulations.

Despite all these requirements, the flexibility of the rules remains, it is accepted and allowed by the accounting standards and even encouraged by the professional environment which is more in line with the phrase "freedom and compliance with accounting regulations".

The choice of one or the other accounting treatment has consequences for the financial statements, so it is preferable that the entity's short-term objectives (obtaining a bank loan, avoiding the imposition of high taxes) do not take precedence over the main objective of honest accounting: reflection of the faithful image.

The flexibility of the rules and the possibility to choose accounting policies favorable to the entity derive the creative accounting practices. Exploiting legislative gaps can also be done in an aggressive manner by defining accounting policies that lead to undeserved benefits for the entity and for certain users of accounting information. In this case, we are talking about masking reality, about reporting a deceptive image of the company made under the protection of the legal nature of creative accounting.

3. Factors that may encourage managers to use creative accounting policies

The situation in which the performances of the managers of the economic entity are measured in accordance with the size of the obtained result often appears in the current economic practice. Thus, managers will be tempted to behave opportunistically, choosing to benefit from those encouraging factors that allow them to maintain these results at a high level.

Pursuing and achieving the financial objectives of the economic entity has facilitated the emergence of accounting innovation, which is defined by some authors as a process in which a transaction is structured in such a way as to allow the application of the desired accounting method. Analyzing the two existing international accounting systems (Continental European and Anglo-Saxon), it is observed that a more prescriptive and inflexible approach to the continental European model reduces the abuse of accounting policies and facilitates the manipulation of accounting estimates. It is also noted that the Anglo-Saxon model leads to the use of re-evaluation and the principle that the substance prevails form. Both models accept creative accounting control, as shown in figure no. 3.

In the context of business globalization, both professional accountants and managers of economic entities are put in a position to find quick solutions to adapt to new information requirements, sometimes without waiting for normalization, thus forcing the need to use influencing factors to find solutions and treatments. to promote the image of the entities they lead and to obtain an advantage, without coming into conflict with the law.

The use of creative accounting practices relates to the accounting imagination used to translate legal, economic and financial innovations for which there are no standardized accounting solutions at the time of their launch, and to the fact that the arrangements arising from this financial engineering are initiated in depending on their impact on the outcome of the entity (Stolowy, 1994).

Figure no 3. Factors that can encourage managers to use creative accounting policies

Encouranging factors for creative accounting	***Solution***	***Principle of application***
* Selecting the accounting method; * Estimates and forecasts; * Concluding artificial contracts; * The real moment of the transaction.	* Limiting choice; * Limiting the purpose of estimates; * The importance of the substance over the form; * Imputation of revaluation.	*Continental European; *Continental European; *Anglo-Saxon; *Anglo-Saxon.

Source: own projection

The review of the literature shows that, although there are misunderstandings about the definition of creative accounting, most researchers acknowledge that, in essence, it is distinguished by two aspects presented in the figure below.

Figure no. 4. The distinctive character of creative accounting

first of all, creative accounting involves using the imagination of experts in the field to translate legal, economic and financial innovations that do not have standardized accounting solutions at the time of their emergence.

second, the arrangements resulting from this financial engineering will be initiated in response to the impact on the entity's performance.

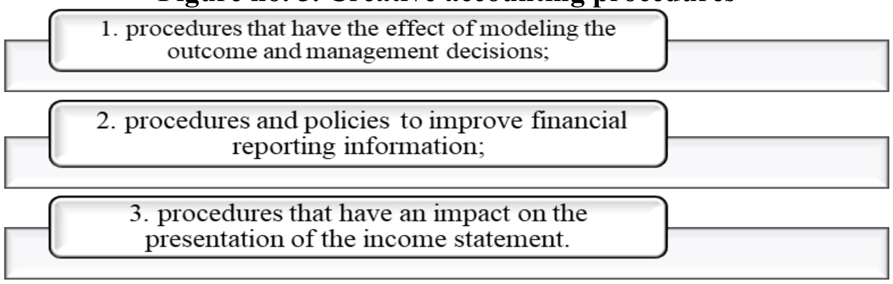
Source: own projection

4. Creative accounting policies with a significant impact on decision making

Creative accounting policies can be used by business managers to change the image of performance. As a result of estimation, rather than an accurate quantification, for example, in the case of unsecured customers, the presentation in financial statements of information such as the fair value of financial assets and financial liabilities, useful life of assets, moral wear and tear of inventories etc., can be done by influencing the results or information provided in the financial statements. The presentation of economic and financial indicators inevitably simplifies the information on the target markets. The choice of one or more indicators is not neutral at all and the information provided is subjective.

Knowing the indicators by which the market is analyzed, the entity is tempted to act on a numerical basis, establishing a direct causal link between the complexity and manipulation of the accounts. The complexity of the account requires simplification, a simplification that works with indicators that are easy to manipulate (Răileanu, Manea and Răpceanu, 2010, p.23). In figure no. 5 shows the ways in which creative accounting classifies its procedures according to the objectives imposed by managers.

Figure no. 5. Creative accounting procedures



Source: own projection

Following this scientific approach, I will briefly analyze a series of procedures, mechanisms and practices specific to creative accounting. Thus, the table no. 1 presents the creative accounting policies and techniques with significant effect in modeling the result.

The existence of various interests determined by some of the influencing factors that can encourage managers to use the above creative accounting policies is closely related to financial markets, where investors play a key role, being fully aware that accounting "options" have always existed. Even if all this leads to a distorted interpretation of the information gathered from the financial statements, the managers continue to support the minimization of the impact of creativity. If the purpose of creative accounting is to take advantage of the weaknesses and shortcomings of accounting regulations to improve the accounts (or image of an entity), the principle of options has been known to experts in the field for a long time, so this concept is not new. Thus, in most cases where creative accounting is disclosed, the choice and application of accounting policies fall within the flexibility of accounting standards and rules.

The way in which the accounting policies are applied is based on the reasoning of the experts and on the desire of the managers to model the financial results in the desired direction (Feleagă and Malciu, 2002, p. 390). However, in many cases, the design and application of certain accounting treatments may be detrimental to the results and financial position reported. It should be noted that accounting legislation allows for the application of alternative treatments, so it cannot be a matter of fraudulent reporting, in most cases it is an aggressive application of accounting policies.

At some point, creative accounting policies exceed the limits of accounting rules, and financial reporting no longer provides a true and fair view of results and financial position. To determine if it is a fraudulent financial report, you must prove its intent. What started out as an aggressive application of accounting policies can result in fraudulent financial reporting if it is continued for large sums and over a long period of time. However, it is not always easy to identify where creative accounting is fraudulent. Determining this point is more about art than science.

Table no.1 Significant creative accounting policies and practices

Identified components	Mechanism of action	Impact on performance	Limitation	The method used to achieve the goal
Research and development expenses	Capitalization of research and development expenditures.	Increasing the result in the year of capitalization; Decrease in the year of the transfer and in the following years due to depreciation; The impact of choosing the beginning date of depreciation.	Fulfillment of the conditions provided by the reporting rules; Difficulties in assessing the cost of research.	Option; Subjectivity in evaluation.
Tangible fixed assets	Lease- back contract.	The emergence of added value from lease-back operations; Recording of rents during the period after taking over the asset.	Artificial increase in the result due to the existence of a commitment to pay rent for a certain period. The risk of distributing fictitious dividends.	Financial mechanism.
Depreciation	When setting the depreciation plan, there are several options and possibilities: -time of use; -estimation of the residual value.	Modification of the recorded depreciation rate, therefore of the depreciation expenses.	The need for a depreciation plan; Permanence of methods.	Personal appreciation; Option.
Goods stocks	Incorporation of financial expenses in the cost of production of stocks.	Increasing the result in the year of incorporation of expenses; Decrease in the year of stock decline.	Difficulty in defining borrowed capital and production financing; The notes must state the justification for the capitalization and the amount of the expenditure.	Option.
Depreciation adjustments and equity securities	Underestimation or overvaluation for the depreciation of participation titles.	Increasing (or decreasing) the result in the year of registration; Reverse effect in the year of resumption.	Prudence principle.	Subjectivity in evaluation.
Depreciation adjustments for current assets	Underestimation or overvaluation for debt depreciation; Underestimation or overestimation of adjustments for depreciation of stocks.	Increasing (or decreasing) the result in the year of registration.	Prudence principle.	Subjectivity in evaluation.
Provisions	There are several problems: -date of the restructuring decision; -degree of accuracy	Impact on the result depending on the level of the provision; Reverse effect in the year of resumption.	Prudence principle.	Option; Subjectivity in evaluation.

	in terms of evaluation; - taking into account the capital gains of the provision (although it is forbidden).			
Long-term contracts	The existence of several methods for registering these contracts: - the percentage of advancement method; -method of finishing the works	Impact on turnover depending on the method used; Different recognition of contract revenue.	Prudence principle.	Option; Subjectivity in evaluation.

Source: Răileanu, Manea and Răpceanu, 2010, p. 28-29.

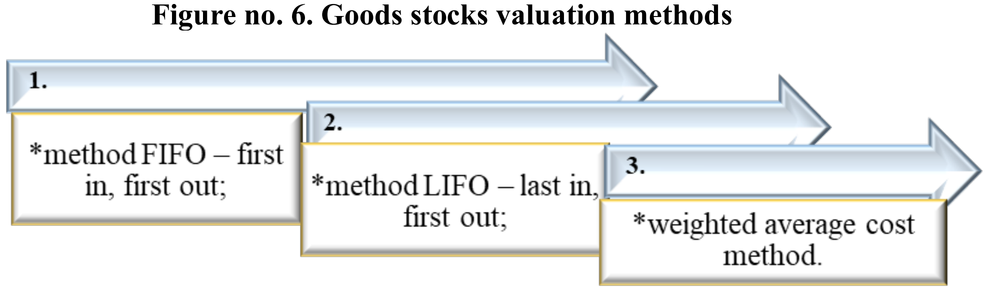
5. Case study: Valuation of goods stocks

By elaborating this case study in my capacity as author, I will follow the influence of the stock evaluation method on the result of the entity SC ONE STORE SRL which registers in March 2022 the following operations in the management of cargo stock X:

- initial stock 1,200 kg at price of 3.6 lei,
- inputs on March 3 of 300 kg at a price of 3.75 lei,
- outputs on March 15 of 500 kg,
- inputs on March 20 of 200 kg at 3.98 lei,
- outputs on March 25 of 550 kg.

The unit selling price was 4.95 lei / kg.

Figure no. 6. Goods stocks valuation methods



Source: own projection

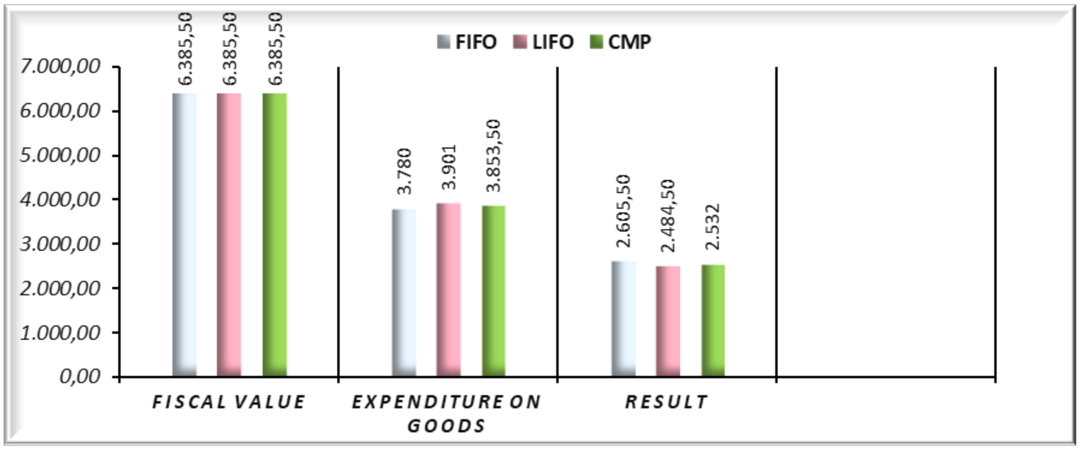
Table no.2 Evaluation of goods stocks using the three methods

Date	Initial stock	Inputs	Outputs	FIFO method	LIFO method	Weighted averege cost method
01.03.2022	1.200x3.6			1.200x3.60	1.200x3.60	1.200x3.67
03.03.2022		300x3.75		1.200x3.60 300x3.75	1.200x3.60 300x3.75	1.500x3.67
15.03.2022			500	700x3.60 300x3.75	1.000x3.60	1.000x3.67

20.03.2022		200x3.98		700x3.60 300x3.75 200x3.98	1.000x3.60 200x3.98	1.200x3.67
25.03.2022			550	150x3.60 300x3.75 200x3.98	650x3.60	650x3.67
30.03.2022	**4320 lei**			**2461 lei**	**2340 lei**	**2385.50 lei**

Source: own projection

Chart no.1 Profit and loss account



Source: own projection

It can be seen from the study presented that the result obtained by the assessed entity depends on the chosen stock valuation method. The FIFO method determines the highest result, and the LIFO method has the lowest result and implicitly the lowest profit tax expense. In addition, if the entity decides to change the method of valuing inventories from one year to the next, it will allow it to smooth the result.

6. Conclusions

Given all the aspects related in the content of this research, a relevant conclusion of the scientific approach can be deduced, namely, creative accounting is a tool to support managers, as it provides information that promotes and supports the image of the entity it leads, but also personal interests which he pursues. Therefore, even if the use of creative accounting is not illegal, it provides managers under financial pressure with solutions that are not in line with ethical standards. In other words, half-truths and lies can be considered susceptible to possible fraud.

The existence of accounting options based on freedom of choice and appreciation determines managers who, depending on the profits pursued or the tendency towards optimism or pessimism, are tempted by the reversal of reasoning or the translation into accounting of legal, economic and financial innovations for which standardization has not yet found solutions. Thus, creative accounting can define opportunities that have the effect of modeling the results and content of financial reporting.

References

1. Bruno, G., 2007. *Les impôts dans les affaires internationales*, 7-e edition, Edition Francis Lefebvre.
2. Bunget, O., 2005. *Contabilitatea românească între reformă și convergență.* București: Editura Economică.

3. *Ghid practic de aplicare a reglementărilor contabile privind situațiile financiare anuale individuale și situațiile financiare anuale consolidate aprobate prin OMFP nr. 1802/2014*, 2015. București: Editura CECCAR, p. 24.
4. Feleagă, N., Manciu L., 2002. *Politici și opțiuni contabile (Fair Accounting versus Bad Accounting).* București: Editura Economică.
5. Groșanu, A., 2013. *Contabilitate creativă.* București: Editura ASE.
6. Gurău, M., Gurău, M.I., 2020. *Contabilitatea în era economiei digitale. Politici și proceduri contabile.* București: Editura Universității din București.
7. Malb, J.L., Giot, H., 1995. *L'elasticite du resultat selon les dimensions temps et espace*, Congrès AFC.
8. Mihăilă, S., Erhan, L., 2015. *Poziționări și evoluții în contabilitatea creativă,* Analele ASEM, Ediția a XIII-a, Nr.1.
9. OMFP nr. 1802/2014 pentru aprobarea Reglementărilor contabile privind situațiile financiare anuale individuale și situațiile financiare anuale consolidate.
10. Raimbourg, P., Boizard, M., 2009. *Inginerie financière, fiscalité et juridique.* Paris: Dalloz.
11. Răileanu, V., Manea, C.L., Răpceanu, C., 2010. *Contabilitate creativă (suport de curs și aplicații practice)*. Bucuresti: ASE București.
12. Răileanu, V., Răileanu, A.S., 2009. *Abordări contabile și fiscale privind impozitele și taxele*. București: Editura Economică.
13. Remenaric, B., Kenfelia, I., Mijoc, I., 2018. Creative accounting – motives, techniques and possibilities of prevention. *Economski Vjesnik / Econviews*, pp.193-199.
14. Ristea, M., Dumitru, C.G., 2012. *Libertate și conformitate în standardele și reglementările contabile.* București: Editura CECCAR.
15. Stolowy, H., 1994. Existe-t-il vraiment une comptabilite creative? *Revue de droit comptable*.