CREATIVE ACCOUNTING IMPACT ON THE ECONOMIC ENTITY'S PATRIMONIAL AND FINANCIAL SITUATION. CASE STUDY.

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***Abstract**: This paper empirically addresses the issue of creative accounting in financial reporting, focusing on how it influences the quality of financial statements prepared and reported by economic entities. Creative accounting cannot be automatically classified as legal or illegal, in the absence of an in-depth analysis, but is negatively correlated with the approach of managers or professional accountants to manipulate accounting data to achieve certain objectives or meet certain financial indicators relevant to third parties. The data were collected from open sources, from databases available to the general public, for the study being selected an economic entity based on certain representative criteria, such as economic size, business segment or history. The study revealed that, based on the analysis of the financial statements prepared by the economic entity for a period of two consecutive years, were highlighted elements that suggest a use of imaginative accounting, being likely to mislead stakeholders about the performances registered.*

***Keywords**: Creative accounting, corporate governance, result management, ethics.*
***JEL Classifications**: M40, M41, M48.*

1. Introduction

The handling of accounting data is located on the thin line that delimits a legal approach, favorable to the economic entity, to the spectrum of fraud, unfavorable to the state or other stakeholders. Abundant case studies in the field of creative accounting, especially addressed in times of economic crisis, have strengthened the negative perception of the public, in the sense that economic entities are tempted to resort to the subjective interpretation of accounting data and circumvent the rules and regulations in force. especially of the control mechanisms.

By determining the professional accountant to present certain financial statements, the manager of the economic entity causes the interpretation of accounting regulations according to his subjective interests, causing a change in external perception of the performance of the economic entity, and thus induces inappropriate, misleading behavior.

The benefits obtained by managers and / or professional accountants, determine them to exploit certain accounting uncertainties to present the summary documents of the economic entity in a more favorable light or to legitimize discretionary managerial decisions (Colasse, 1991). Thus, the methods of accounting representation largely depend on the purpose assigned to the accounting information and the point of view adopted.

Accounting is governed by regulations and principles that should guarantee ethics, the transparent transmission of financial information and the fair accounting representation of the economic entity (Genesse, 1995).

The real image of the financial situation of the economic entity is essential, the appreciation of the right application of the accounting principles in the elaboration of the accounting documents being relevant for the external actors of the economic entity.

This study aims to establish the extent to which creative accounting allows the manager to manipulate the financial information of the managed economic entity and to influence the perception of it by stakeholders. To answer these questions, the first part of the paper presents the basics of creative accounting and explains its interest in the current context.

The second part illustrates the theoretical framework applied to a concrete case, analyzing the extent to which elements specific to creative accounting can be highlighted and, if any, how their application could affect the economic entity.

2. What is creative accounting?

The notion of creative accounting, developed by the Rochester school in the current of accounting positivism, is defined by Watts and Zimmerman (1986) as "the set of accounting techniques used by the manager to change his accounts in a way favorable to his expectations."

Gosh (2010) considers creative accounting as a change in accounting figures in what managers and professional accountants want by exploiting gaps in existing rules and / or ignoring some of them.

According to Stolowy, H. and Breton, G (2004), managers of economic entities in difficulty choose for the implementation of an accounting policy in a preferential manner, with the aim of managing published results. Thus, creative accounting methods can be taken to the extreme and the intentional use of these techniques, outside the legal regulations, can reach the limit of abuse or fraud.

In a difficult economic context, the manager has the interest to exploit all the possibilities offered to him to meet the expectations of the various economic actors. In order to deal with a crisis affecting the sector in which an economic entity operates, its manager may decide to change its choices regarding the accounting policy applied.

Therefore, if the communication of financial information remains a legal obligation, it is increasingly part of a voluntary and control process for managers, used for the purpose of embellishing the results prepared by the economic entity.

Improving the company's image by selecting and presenting advantageous information is one of the possible manipulation options, being speculated especially some gaps in accounting regarding the presentation of accounting and financial indicators, by applying creative accounting techniques, mainly for communication purposes and avoidance of fiscal obligations.

Strategies consolidated as a result of the globalization of the economy and rapid changes in the economic, technological and social environment, determine economic entities to react quickly and adapt their behavior. To cope with this unstable environment, the manager must constantly integrate new information and may, in some cases, use creative accounting techniques to meet stakeholder expectations (Beneish, 1999).

Creative accounting techniques allow the manager and the professional accountant to adapt their strategy to the economic changes that have taken place, but they are likely to affect external financial communication.

An important motivating factor for the use of creative accounting techniques and methods is the reflection of an improvement in the financial performance of the economic entity in order to access financing from credit institutions.

Pursuing this goal, the management of the economic entity is tempted to resort to a series of manipulative techniques in the field of creative accounting, which can be found in the legal area and in legal regulations, but we cannot neglect the possibility of exceeding legal limits to achieve the goal.

3. Some creative accounting techniques

- ***Incorrect recognition of income***

In the course of current activity, sales agreements may be subject to changes made legitimately, the right to return or exchange offered to buyers not being blamed, to the extent that revenue is recognized in the relevant accounting period.

However, the terms and conditions of the sale may be subject to change or the sale may be revoked outside the recognized sales process or the usual reporting methods and may affect the recognition of revenue. Usual changes may include extended payment terms, refunds or exchanges.

- ***Registration of a sale outside the contractual provisions or legal regulations***

A transaction involving the issuance of an invoice for the sale of a product without its actual delivery to the buyer may take place when the product has been reserved but the delivery, respectively the transfer of ownership, did not take place on the date of registration of the sale.

Although the transaction may be based on a legitimate order or purchase intention, the customer may not yet be prepared or willing to accept receipt of the product on the date of the sale recorded by the seller.

- ***Artificial increase of the stock value***

Stock valuations can be adjusted in several ways, including by moving stock between locations owned by the economic entity, with the aim of artificially increasing the amount of stock, hiding low-moving stocks or misappropriating of stocks.

Economic entities may increase the stock of goods by falsifying journal entries, proven by unfinished purchase orders or by doubling the registration of purchases. One of the reasons why economic entities use such means of manipulation is to reduce the cost of sales relative to turnover, in percentage terms.

- ***Inadequate asset valuation***

Casuistry demonstrated the existence of a direct relationship between the overvaluation of assets and the increase of income. The concealment or incorrect recording of items in the balance sheet, which should normally be recorded in the income statement, are creative accounting techniques. Asset overvaluation is often seen as a preferred way for professional accountants to directly manage reported earnings.

- ***Inadequate capitalization of expenses***

Capital expenditures should be amortized over the life of the asset, which are costs that the economic entity incurs over several accounting periods. Thus, in order to avoid the recognition of all expenditure in the current period, economic entities may improperly speculate on certain expenses that can be capitalized in various asset accounts and may include costs of interest, personnel, inventory, etc.

- ***Estimation adjustments***

Changing the accounting estimate, which directly affects the debt or equity of the economic entity, is a common practice throughout the accounting process and can be manipulated to have an impact on income, expenses or assets and liabilities.

In this context, the management of the economic entity is in a position to influence the estimates, depending on certain interests, the creative accounting methods and techniques used involving the reduction of accumulations or reserves to increase gains in the current period.

4. Results and discussions

The analysis of the performance of the economic entity has a central role in determining the extent to which management has resorted to the application of creative accounting techniques, the literature showing that such behavior increases in intensity during periods of economic and financial crises.

The analysis was based on data from the balance sheet of the economic entity SC LEZEM NIF SRL, active in the food industry, integrating in the analysis a system of relevant indicators, through which relevant conclusions can be found that can highlight the motivation that determined managers and / or professionals accountants to resort to the manipulation of accounting data, respectively conclusions can be drawn regarding future developments.

In our study we have approached a representative suite of financial indicators that would allow the issuance of relevant conclusions regarding the presence of manipulative elements in the patrimonial and financial statements prepared by the economic entity under analysis.

For this, we performed a comparative analysis of the balance sheet elements and financial indicators by reporting the situations related to 2019 to those prepared by the economic entity in 2018.

In the following we have made a presentation of the balance sheet elements, mentioning those changes identified from one period to another that have an uncertain character in terms of reality.

The structure of the assets in the patrimony of the analyzed economic entity can be summarized below (the values are expressed in lei).

Asset structure of SC LEZEM NIF SRL

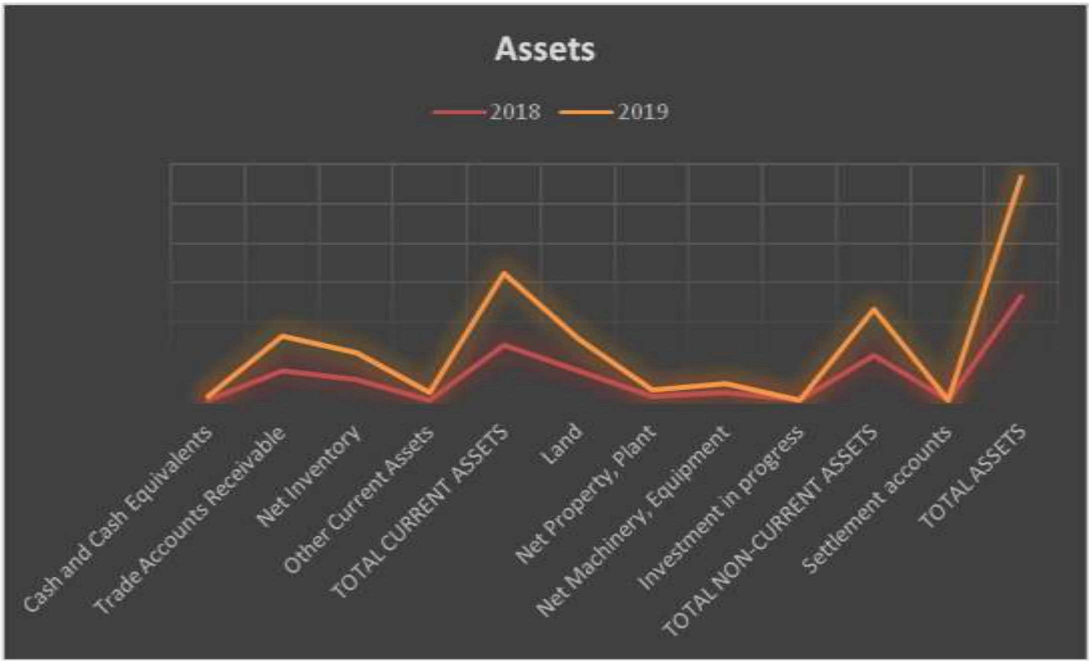
Table no. 1

BALANCE SHEET	2018	2019	2019 vs. 2018
Cash and Cash Equivalents	309.000	1.085.216	251%
Trade Accounts Receivable	7.711.831	8.992.156	17%
Net Inventory	5.661.568	6.681.915	18%
Other Current Assets	699.121	1.456.486	108%
TOTAL CURRENT ASSETS	**14.381.520**	**18.215.773**	27%
Land	7.903.551	7.903.551	0%
Net Property, Plant	1.199.146	1.596.846	33%
Net Machinery, Equipment	2.410.516	2.149.319	-11%
Investment in progress	98.619	4.516	-95%
TOTAL NON-CURRENT ASSETS	**11.611.832**	**11.654.232**	0%
Settlement accounts	655.616	315.946	-52%
TOTAL ASSETS	**26.648.968**	**30.185.951**	13%

Source: elaborated by the authors

Graphic representation of the evolution of the assets of SC LEZEM NIF SRL

Figure no. 1



Source: elaborated by the authors

Based on the patrimonial elements previously presented, we determined the specific rates for each component of the company's assets, as presented below.

- ***Fixed assets ratio***

The indicator reflects the share of the patrimonial elements permanently in the patrimony of the economic entity and measures the degree of immobilization of the capital elements.

Fixed assets ratio (2018) = (Fixed assets) / (Total assets) x 100 = 43.57%

Fixed assets ratio (2019) = (Fixed assets) / (Total assets) x 100 = 38.61%

It is thus observed that fixed assets hold a significant share of the total assets of the economic entity, being highlighted a percentage decrease from one period to another, although the dynamics is positive, and this against the background of accelerated increase in current assets, especially receivables and inventories compared to fixed assets.

- ***Current assets rate***

This type of assets has a major significance in the activity of an economic entity, based on the balance sheet data of the analyzed economic entity being obtained a series of indicators. The current assets ratio is given by the relation:

Current assets rate (2018) = (Current assets) / (Total assets) x 100 = 53.97%

Current assets rate (2019) = (Current assets) / (Total assets) x 100 = 60.35%

As mentioned above, the current assets ratio is at a reasonable level compared to the fixed assets held by the entity. However, in addition to the percentage increase in current assets in total assets from one period to another, there is a significant increase in current assets, by 27% in 2019 compared to 2018.

Of these, we took into account the share of stocks and trade receivables in the analyzed economic entity. Those rates are calculated from the relationships below

Inventory rate (2018) = Stocks / (Total assets) x 100 = 21.24%

Inventory rate (2019) = Stocks / (Total assets) x 100 = 22.14%

Customer receivables rate (2018) = (Customers and similar accounts) / (Total assets) x 100 = 28.94%

Customer receivables rate (2019) = (Customers and similar accounts) / (Total assets) x 100 = 29.79%

The changes in the share of current assets from one period to another (6.38%), corroborated with the increase identified in both the customer receivables account (17%) and the inventory account (18%), involve certain suspicions regarding concerns of veracity of the input data used in the preparation of the financial statements.

Similarly, using the data from the balance sheet of the economic entity, we calculated the relevant indicators regarding the liability accounts. The main balance sheet liabilities related to the financial years 2018 - 2019 are summarized in the chart below, being made on the basis of absolute and relative data on the liabilities included in the balance sheet of the economic entity. The structure of the liabilities of the analyzed economic entity can be summarized in the table below, respectively in the chart below.

Liability structure of SC LEZEM NIF SRL

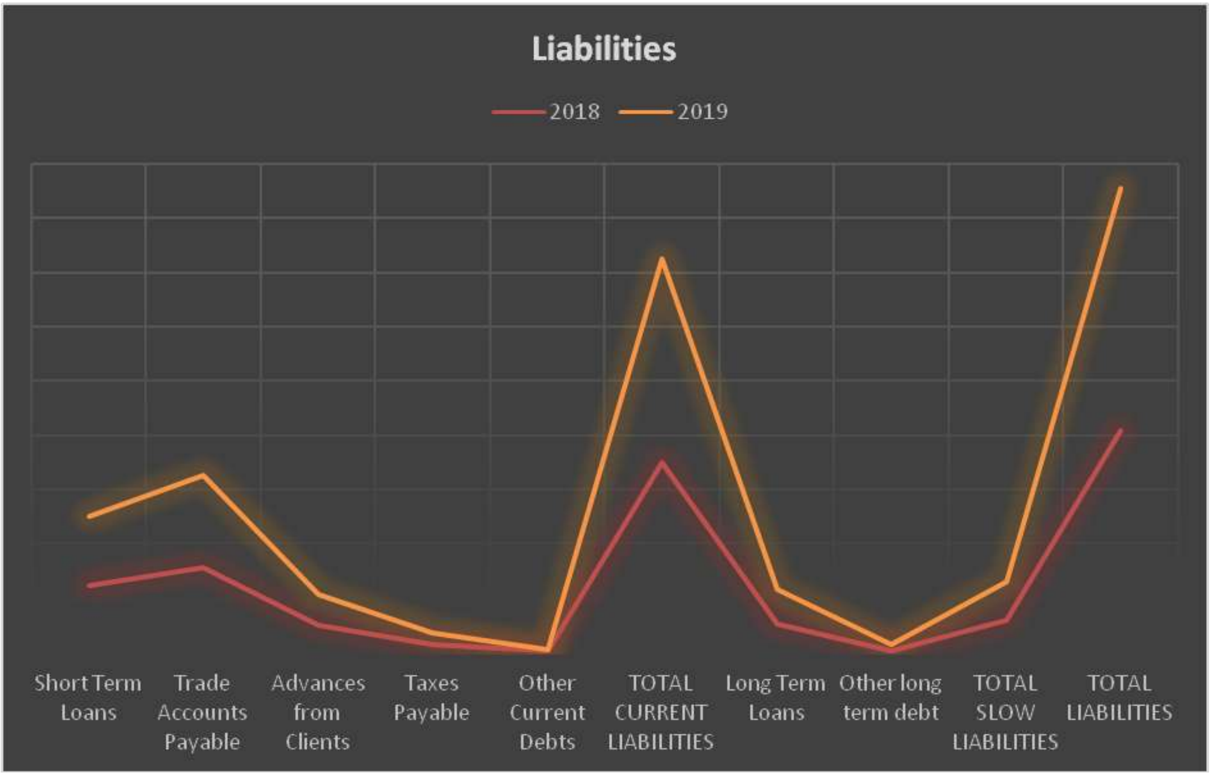
Table no. 1

	2018	2019	2019 vs. 2018
Short Term Loans	6.205.469	6.334.696	2%
Trade Accounts Payable	7.861.496	8.496.496	8%
Advances from Clients	2.510.618	2.864.869	14%
Taxes Payable	799.469	999.187	24,98%
Other Current Debts	121.516	89.463	-26%
TOTAL CURRENT LIABILITIES	**17.498.568**	**18.784.711**	7%
Long Term Loans	2.694.568	3.116.497	16%
Other long-term debt	285.468	421.649	48%
TOTAL SLOW LIABILITIES	**2.980.036**	**3.538.146**	19%
TOTAL LIABILITIES	**20.478.604**	**22.322.857**	9%

Source: elaborated by the authors

Graphic representation of the evolution of liabilities at SC LEZEM NIF SRL

Figure no. 2



Source: elaborated by the authors

The analysis performed, based on the calculated data, reveals that the debts with a repayment term of up to one year have a significant share (85.45% in 2018, respectively 84.15% in 2019) in the total liabilities of the economic entity.

This indicator reflects the share of debts due within 1 year in the total liabilities of the economic entity, and is given by the following relation:

Share of short-term debts in total liabilities (2018) = (TS debts) / (Total liabilities) x 100 = 85.45%

Share of short-term debts in total liabilities (2019) = (TS debts) / (Total liabilities) x 100 = 84.15%

Regarding the debts due within a period of up to 1 year, there is a slight increase from one period to another, with advances from customers knowing the largest advance (24.98%). The structure of short-term debt is calculated according to the relationships below.

Share of loans in debt on TS (2018) = (TS loan) / (TS debts) x 100 = 35.46%

Share of loans in debt on TS (2019) = (TS loan) / (TS debts) x 100 = 33.72%

Share of suppliers in debts on TS (2018) = Suppliers / (TS debts) x 100 = 44.93%

Share of suppliers in debts on TS (2019) = Suppliers / (TS debts) x 100 = 45.23%

The variations registered in the short-term accounts have known an evolution that does not suggest subjective interventions likely to manipulate the result published by the analyzed entity.

However, in order to assess the reliability of the data, a detailed analysis is required, the limitations of this study being obvious as the analysis is based exclusively on the situations presented by the economic entity, and no possible omissions can be assessed.

Analyzing the main elements of the profit and loss account could be highlighted a series of developments that we will treat individually, analyzing the degree to which evidence of manipulative behavior can be identified.

The structure of the profit and loss account can be summarized in the table and the chart below, respectively:

The structure of the profit and loss account of SC LEZEM NIF SRL

Table no. 3

	2018	2019	Variation (%)
TURNOVER/SALES	63.636.098	77.463.058	21,73%
- Cost of Goods Sold	57.991.608	70.715.989	21,94%
GROSS OPERATING PROFIT	5.644.490	6.747.069	19,53%
+ Other Operating Incomes	864.968	764.587	-11,61%
- Salary Expense	2.391.886	2.654.915	11,00%
- General /Selling/ Admin. Expenses	1.468.498	1.214.652	-17,29%
- Depreciation Expense	699.818	589.169	-15,81%
NET OPERATING PROFIT	1.949.256	3.052.920	56,62%
- Interest Expense	1.256.159	1.416.940	12,80%
+/- Gains/Losses on FX	5.618	54.548	870,95%
PROFIT BEFORE TAXES	698.715	1.690.528	141,95%
Less: Income Taxes	156.499	164.968	5,41%
NET PROFIT AFTER TAXES	542.216	1.525.560	181,36%

Source: elaborated by the authors

Graphic representation of the profit and loss account of SC LEZEM NIF SRL

Figure no. 3

Source: elaborated by the authors

Analyzing the variations registered from one period to another, there is a positive evolution of turnover, increasing by 21.73%, broadly in correspondence with the evolution of the cost of goods sold (21.94%). Although apparently the correlation between the two elements would not raise suspicions, the significant increase in turnover may be the result of marking some income in advance, outside the contractual provisions.

The hypothesis is supported by the significant improvement of the profit margin (by 56.62%), a trend that is not within the specific margins of the activity segment, characterized as being extremely competitive.

At the same time, certain unjustifiable decreases in depreciation expenses could be observed, which are not necessarily in line with asset dynamics, thus generating indications regarding the application of extensive depreciation policies.

Creative accounting, using as a method the extension of the amortization period, to spread the expenses over several periods, can be used to determine the incorrect capitalization of costs, thus being able to induce a wrong view of the financial statements.

The use of an aggressive stance regarding the selection of the life and residual value of property, plant and equipment is distorted to lead to irregularities in financial reporting.

Analyzing the financial structure of the capital of the economic entity, several conclusions could be drawn. In the following we will address the main financial indicators relevant for assessing the financial performance of the analyzed entity.

- ***Financial stability rate***

This indicator reflects the share of financing sources that remain at the disposal of the economic entity for a period longer than one year compared to the total financing sources of the economic activity. In this sense, we calculated the financial stability rate, using the relation:

Financial stability rate (2018) = (Permanent capital) / (Total liabilities) x 100 = (Equity + medium and long-term debts) / (Total liabilities) x 100 = 34.34%

Financial stability rate (2019) = (Permanent capital) / (Total liabilities) x 100 = (Equity + medium and long-term debt) / (Total liabilities) x 100 = 37.77%

- ***Global autonomy rate***

The indicator reflects the share of own sources in the total sources used to finance the activity of the economic entity. In practice, it is recommended that the share of own sources of financing be at least 33% of the total sources of financing used by the economic entity. The indicator is calculated based on the relation:

Global autonomy rate (2018) = (Equity) / (Total liabilities) x 100 = 30.13%

Global autonomy rate (2018) = (Equity) / (Total liabilities) x 100 = 35.22%

Starting from the optimal reference value of this indicator, the improvement of the indicator from one year to another by 5 percentage points, up to this threshold, in the case of the analyzed entity, raises a doubt about the possibility of manipulating the financial statements.

- ***Current ratio***

The indicator measures the ability of the economic entity to pay short-term debts by capitalizing current assets.

Current ratio (2018) = (Current assets) / (Current liabilities) x 100 = 0.82

Current ratio (2019) = (Current assets) / (Current liabilities) x 100 = 0.97

The literature indicates as optimal the reference range 1.5-2 to indicate the ability of an economic entity to honor its short-term obligations. Being below this range means that the economic entity will have to access loans or capitalize fixed assets.

In the case of the analyzed entity, an improvement of the indicator can be observed, an additional argument for the hypothesis of using creative techniques to improve the image of the financial performance registered by the entity concerned.

Assessing the turnover rate of customers, stocks or suppliers allows the determination of possible problems (slow-moving stocks, bad paying or late paying customers, respectively highlighting difficulties in paying debts to suppliers), a low value of the indicator (calculated in days) being desirable, at the opposite pole being an increasing dynamic of these rates. In the case of the analyzed entity, the indicators show some positive fluctuations.

- ***Days Receivable***

Days receivable (2018) = (Customer receivables) / (Turnover) x 365 = 44 days

Days receivable (2019) = (Customer receivables) / (Turnover) x 365 = 42 days

- ***Days Inventory***

Days inventory (2018) = Inventories / (Cost of goods sold) x 365 = 35 days

Days inventory (2019) = Stocks / (Cost of goods sold) x 365 = 34 days

- ***Days Payable***

Days payable (2018) = (Suppliers + Crediting customers) / (Cost of goods sold) x 365 = 64 days

Days payable (2019) = (Suppliers + Creditor customers) / (Cost of goods sold) x 365 = 58 days

The rates determined for the analyzed economic entity show an improvement of the rotation terms from one period to another, which suggests a detailed analysis carried out by the management regarding these accounts, the decisions adopted being effective, provided that they were not formal, respectively to be the result of a manipulative intervention on those slow-moving accounts.

- ***Debt to equity***

The indicator aims at assessing the economic entity's capacity to cover the debts due in the event of a business crisis. The indicator is an important variable used in corporate finance, measuring the degree to which an economic entity can finance its current activity through attracted debts compared to the funds held.

Debt to equity (2018) = (Total debts) / (Total equity) = 3.32

Debt to equity (2019) = (Total debts) / (Total equity) = 2.84

- ***EBITDA***

The term is defined as the profit obtained before interest, taxes, depreciation and amortization and reflects the financial performance of an economic entity. The indicator contributes to the substantiation of investors' decisions or to the decision of credit institutions to grant financing, being an indicator used mainly due to the limited possibility to suffer manipulations using creative accounting techniques.

EBITDA = Gross result + Other income – Salary expenses salaries – General expenses – Provisions expense

EBITDA 2018 = 2,649,074 lei

EBITDA 2019 = 3,642,089 lei

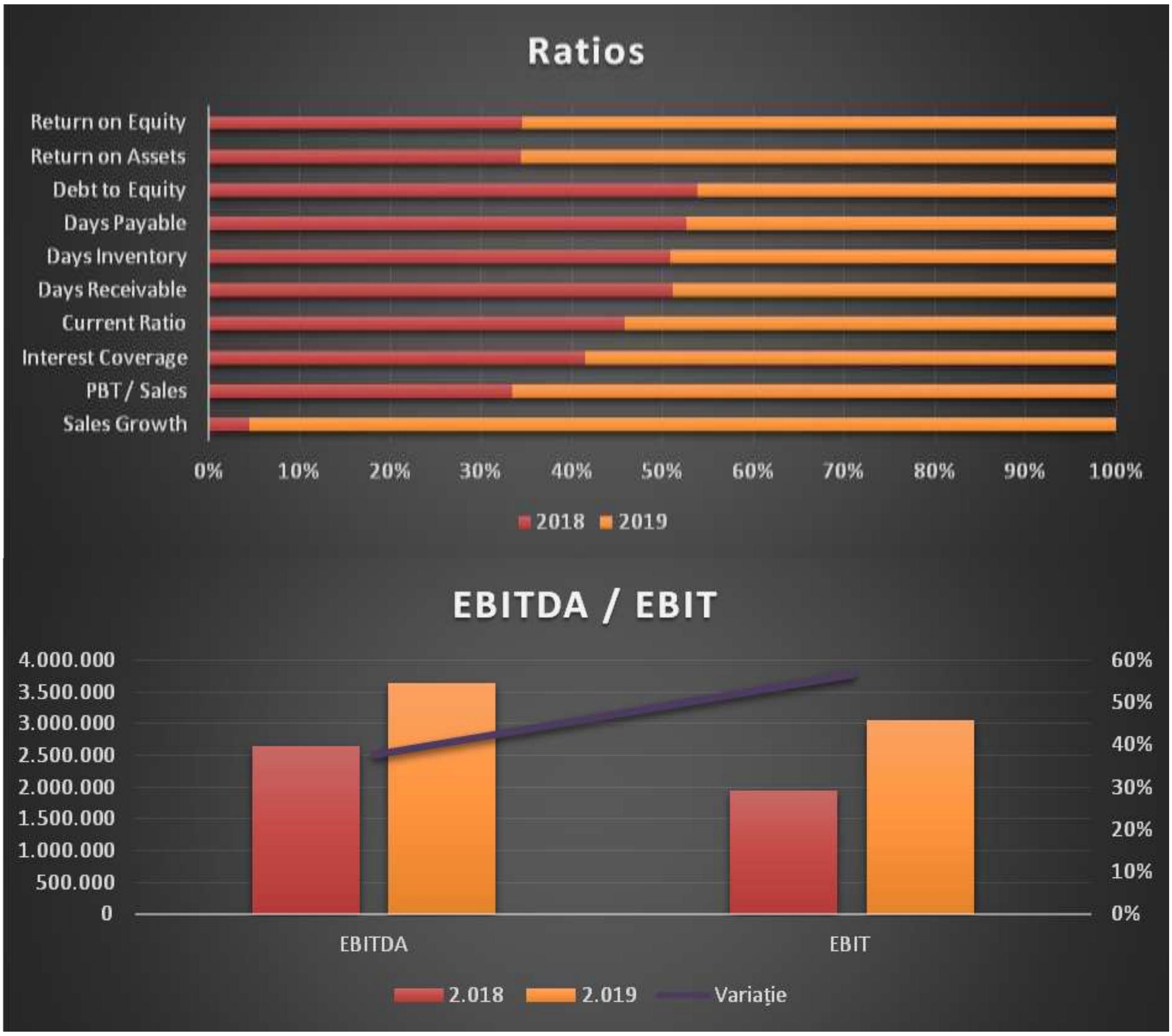
Along with the dynamics of turnover, profitability or assets and liabilities, the last two indicators, namely the degree of indebtedness and EBITDA are essential in the analysis carried out by credit institutions when assessing the opportunity to provide financing to an economic entity.

In the case of the analyzed economic entity, the dynamics registered from one period to another of the degree of indebtedness and EBITDA, although the manipulation of the last variable raises some challenges for the accounting professionals, present variations that lead to the hypothesis of a subjective intervention in the financial statements. with the obvious aim of presenting an improved image, superior to the real one.

Graphic representation of the variation of the main financial indicators

of SC LEZEM NIF SRL

Figure no. 4



Source: elaborated by the authors

Based on the analysis of the financial statements prepared by the economic entity, conclusions could be deduced that suggest a use of imaginative accounting techniques and methods, the results obtained being likely to mislead stakeholders about the performance of the entity, supporting the first hypothesis, namely "*the manipulation of financial statements is likely to mislead stakeholders*".

Also, the results of the study found that the creativity and innovation of the manager and / or professional accountant, in applying accounting regulations, led to a significant improvement in performance of the economic entity in 2019 compared to 2018. The results of the analysis also shows that creative techniques can have a significant impact on the financial results published by the analyzed economic entity, thus confirming the second hypothesis of the paper.

In an attempt to contextualize the positive developments recorded by the economic entity from one period to another, in economic-financial terms, the alleged approach of management to manipulate accounting data may be closely correlated with the attempt to disseminate to financial institutions a consolidated position for ensure access to finance.

On the other hand, a possible interest associated with the conclusion of a transaction aimed at selling the economic entity to an investment fund or attracting an investor should not be neglected, aspects that could be highlighted, to a certain extent, in case of an audit of financial statements, performed by an independent entity.

5. Conclusions

Creative accounting is in itself a phenomenon that can have significantly negative consequences on the economic environment and the economy in general. Also called imaginative accounting, by the simple fact that it is the cumulative result of the experience and imagination of the professional accountant, it not only presents altered, unreal data to shareholders or investors, but affects the credibility of statistics on certain fields of activity, or simply changes perception formed upon the development of a state's economy.

In addition to the unrealistic image provided by the statistics, the existence of a close relationship between the accounting result and the tax system is another dimension that requires attention, given that creative accounting can directly affect the collections made to the state budget, with unpredictable effects on the state's ability to effectively allocate resources to the economy.

Another undesirable effect of creative accounting is to induce a state of uncertainty in business relationships between economic actors, calling into question the decision of an economic entity to engage in economic relations with new partners, regardless they are customers or suppliers.

The manifestation of creative accounting cannot be questioned, so it is necessary to fully understand the factors that motivates a manager or professional accountant to abandon ethical rigors and / or exceed legal regulations and anticipate possible circumstances that could encourage creative practices, the ultimate goal being to limit or prevent their incidence.

No matter how cumbersome the literature on the subject of creative accounting may be, a reliable and undeniable way to fully prevent the manipulation of accounting data has not been identified, or is not generally valid.

International practice has shown that when managerial interests converge with those of shareholders, detecting, or early detection of accounting manipulations is a difficult task. Moreover, economic entities that are ultimately found to resort to such practices are those that resort to excessively aggressive manipulative techniques, with flagrant overcoming of legal norms.

Achieving a high level of expertise in the field of creative accounting techniques and methods, creating an easy-to-apply and comprehensive regulatory framework, reducing taxation, creating a predictable legal framework, and in-depth examination of other determinants are elements that can be solutions for discouraging, limiting, or simply eliminating the need to resort to accounting manipulation.

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