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**CREATIVE ACCOUNTING IN THE CONTEXT OF EFFICIENT
MANAGEMENT IN THE BANKING SYSTEM**

Ph.D coordinator:

Professor TODEA Nicolae, Ph.D

Doctoral student,

GÎNȚA Anca Ioana

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Key words: creative accounting, faithful image, fraud, accounting information, users of accounting information, practices of creative accounting, corporate governance, performance of economic entity, rotation of audit companies, double taxation avoidance agreements, tax haven, creditworthiness, operational lending flow, financing decision.

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Introduction

Motivation for choice of theme

The globalization process and especially the complexity of contemporary economic life increase the importance of information in decision-making process. Across time, changes which appeared in legislative field in fiscality, accounting, led to the appearance of methods of representing economic information which reflect more or less transparently the state of fact of an economic entity. The purpose of an economic entity which benefits from limited resources and works in a competition economy is in reality to render more efficient its activity; the information is the main efficiency instrument, which represents the richest resource of these times.

The idea of managing to deeply understand the reality transposed in the financial statements of an entity is a subject of particular importance for the economic entity and for its partners and institutions with which it comes in contact. This is the idea from which we started in realization of this work with the purpose of making known the various aspects of using creative accounting starting from the methods of practitioners which will help us identify later more easily the cases when they resorted to "cosmetization" of financial statements and later by approaching the motivation for which they resort to these techniques and the implications of their application.

In our opinion, the use of creative accounting is a result of flexibility permitted by the current accounting regulations which, if they are used with good faith, help to illustrate a faithful image of the financial statement and performances of companies.

The scientific research in this field of creative accounting is not in a very advanced development stage, the subject is still sensitive in the light of professional ethics. The approach from the point of view of creditworthiness evaluation in the analysis process in view of financing by a financial institution is less approached, which is one of the reasons for selection of this theme.

This work does not want to support, nor fight against the use of creative accounting techniques, what we want is to draw up vast research, that by its five chapters develops the creative accounting concept in the light of its multiple approaches, debates the main

development directions and presents in the pragmatic way the implications of creative techniques on the decisions of users of accounting information, mainly the financiers in the lending process.

The research project analyses aspects which influence the decisions of companies and especially the users in the financial banking system, issued aiming at cosmetization of result by its maximization when the purpose is to attract new investors or on the contrary, its minimization when the interest is to pay lower taxes.

For those who are against the idea of using creative accounting techniques, this work can serve as an instrument which widely presents creative accounting techniques frequently encountered by which the user can easily detect the accounting manipulations and can make decisions in full knowledge of the cause; one of the motivations on which this piece of research is based is the desire to widen the pool of knowledge of the users of accounting information regarding these techniques, the manner in which they can be detected and their implications. Another motivation in choosing this theme was the desire to widely debate a series of this kind of practices without supporting or fighting against their use.

In fact, for those who intend to "cosmeticize" the financial statements, this work apart from offering a description of creative accounting practices accompanied by practical examples, specifies the risks of using such techniques and their consequences both for the entity and the person who resorts to them with bad faith.

The approach from the point of view of users of accounting information from the financial banking system and the way in which the financing decision of a company influences the creative accounting techniques is in a less explored stage now, the bibliography available is relatively restrained, which represents one of the novelty elements brought by this research.

In an economic environment governed by risks and uncertainties, an adequate risk control is one of the stringent problems that concern both the managers, governments, auditors, capital owners, taxpayers, banking institutions, investors and general public. The knowledge of the methods of manipulating information – the most valuable asset companies hold in these times – represents a subject of wide interest for all the categories of users of accounting information. In this context described above we find the motivation of choosing the theme of Ph.D thesis with the title "*Creative Accounting in the context of efficient*

management in the banking system". The final results of economic entities have effects on the health condition of Romanian economy and in particular of the financial banking system.

Topicality of research theme and stage of knowledge in the field of creative accounting

Considering that in the last two decades the economic reality was shaken by many financial scandals, the specialised publications have begun to pay more attention to the creative accounting phenomenon.

The creative accounting concept appeared in 1980s in United Kingdom and referred to the accounting artifices used to maximize the results and to attract investors. The subject was less treated at that time, its approach with greater interest appeared only after resounding financial scandals.

Most of times a general vision of creative accounting is brought close up and the manner in which one can remove this phenomenon of manipulating figures is less detailed. In the 1990s more works were written on this subject. By analysing the studies and definitions from this period we notice that the academic authors do not highlight the appreciation of legality or illegality of these accounting practices, their focus is on the creative techniques.

After 2000, the fact that technology exploded and the resounding financial scandals of reputed companies such as Enron, Parmalat, Tyco, etc rose the interest of specialists in accounting on this subject. Also, these scandals diminished the confidence in the information presented in financial statements even when they were audited. The subject became more and more interesting, since that time the manipulation of accounting numbers has become a subject of interest because the manipulation of numbers has become a more frequently encountered practice.

In the following years the specialised literature presented new perspectives about creative accounting and that this was the result of deficiencies in the legal accounting framework in addition to the greed of owners and managers.

If in foreign literature there are many works on this subject, in specialised literature of Romania the approach is still insufficient. As for the writings in which accounting creativity is

connected with taxation, there are both national and international approaches; if we are talking of connection with the financial banking field or audit the works on these themes are very few.

Objects and work hypotheses pursued in research

The objectives of this work consist of:

- 1. This work wants to reveal the benefits and risks involved by the use of creative accounting techniques;*
- 2. The highlight of as many sides of this subject so that the reader can objectively appreciate the timely nature, morality, risk or legality of these practices;*
- 3. Analysis of connection between corporate governance and creative accounting;*
- 4. Materialization of a useful study that can be used in detection of creative accounting practices;*
- 5. Detailed approach of creative accounting aspects by presenting the factors which lead to use of creative accounting methods;*
- 6. Integration of accounting creativity in national accounting and fiscal regulations;*
- 7. Identification of creative accounting techniques and their impact on the balance sheet and profit and loss account;*
- 8. Making the distinction between what is legal and what is not, what is fraud and what is not fraud, what is innovation and what is manipulation;*
- 9. Proposal of methods of fighting against accounting creativity and measures of detection and prevention of practices which have the purpose to manipulate and hide truths;*
- 10. Evaluation of audit impact on accounting creativity and the evaluation of creditworthiness in financial analysis process;*
- 11. Critical analysis of the impact of these creative accounting techniques on the decision-making process of management in banking system;*
- 12. The specific objectives of the study refer to the impact of creative accounting problems on a faithful image and on the decisions made based on the projected image.*

In empirical studies we had the following 2 operational objectives: evaluation of audit role in fighting the phenomenon of manipulation of accounting information by creative

accounting and evaluation of the impact of using creative accounting on the financial decision of the persons involved in the loan approval flow in financial institutions.

The research hypotheses were:

H1: In fighting the phenomenon of manipulation of accounting information by creative accounting and in view of assuring a faithful image the rotation of audit companies is important both from the point of view of managers and representatives of financial department and auditors;

H2: The impact of creative accounting is significant in the analysis process and the process of making the financing decision in the loan approval flow in financial institutions.

Finally, we want to highlight the impact of these accounting options at the evaluation of financing risk in the light of evaluating the creditworthiness and financial performance of a company in order to establish its eligibility to obtain financing.

Research Methodology

As first step, we proceeded to ***positioning*** the approached issue ***in the sphere of knowledge***. Starting from this idea, this work is in accounting scope and the research theme is creative accounting as *instrument in approaching economic entities by the banking system*; the theme is in the general scope of investigation of creative accounting as subfield of accounting particularized in the evaluation of risks involved in decision-making of financial banking institutions in relation to companies.

We aimed to explain in detail the conceptual and practical issues of creative accounting, and we tried at the same time to offer forecasts about the evolution of practices and regulations in this field.

This scientific step *combines the qualitative research with quantitative research*, if we refer to research *methodology and research perspective*. The perspective is theoretical, descriptive, conceptual and practical – examples and practices in the field. We analysed the specialised literature representative at national and international level by fundamental scientific research method; among the fundamental research specific methods we mention:

classification, comparison and measurement of qualitative and quantitative characteristics. For the realization of this work we used the following types of information sources:

- printed sources – specialised books, articles published in specialised magazines, reference works, international accounting standards and Ph.D theses.
- electronic sources of information: journals, magazines and other documents in electronic format.

We also presented in our work many notable examples of using creative accounting in companies at world level, but also in financial banking institutions, which caused a serious and significant impact.

The quantitative research method used for validation of work hypotheses defined is the research by statistical survey by questionnaire. We applied two questionnaires in which we used only questions with closed-type answers. The presentation of results of empirical studies carried out by graphical representations increases the quality of information obtained. Following the two studies, both work hypotheses were confirmed.

Synthesis of the main parts of Ph.D thesis

We tackled in the first part of this work two important subjects which make the introduction to the theory related to the thesis theme, but also the presentation of practical techniques in general and later we developed the idea of creative accounting in economic field with fiscal implications; finally, we resorted to a practical approach of risks and benefits that creative accounting brings to the banking field in the process of loan analysis for making the financing decision by the management of financing institution.

The first chapter- Creative accounting versus fraudulent practices in accounting – we develop a few *General considerations regarding creative accounting*; this part of research has a theoretical nature, we presented the concept of creative accounting, faithful image and fraud and the relationship between the latter and creative accounting; we made an analysis of the current Romanian accounting environment and the level where the accounting regulations are, but last and not least, we analysed the accounting profession in this context of creative accounting and the impact that corporate governance has on creative accounting; we

tried to identify the negative and positive aspects and the benefits brought by the use of creative accounting.

In this chapter we developed the *methods of creativity manifestation in accounting and their effect on the financial statements*. This chapter has a mainly practical nature, because we presented creative accounting techniques, their impact on balance sheet and profit and loss account; from the point of view of impact on balance sheet, the techniques are analysed in the following directions: the fixed assets, at level of current assets, in the direction of equity and liabilities; at the level of presentation of information, the creative techniques are analysed by the effect on result and changes at balance sheet position level. Creative accounting is strictly related to the accounting practice, because it initiates it, so the approach of practice is the most relevant.

Another topic approached – *role of financial audit in the control of creative accounting practices* – is in close connection with the practical aspects of the accounting creativity notion and also the limitation of their use to the detriment of users of accounting information and the illustration of a faithful image of the company subject to audit. We emphasized the importance of rotation of audit companies by presenting the reasons for and against the rotation of audit, and highlighted its effect on objectivity, independence of auditors and the audit opinion. In order to determine the role of audit in fighting the phenomenon of manipulation of accounting information by creative accounting, we carried out an empirical study based on questionnaire.

In **chapter 2 entitled "Accounting creativity in double taxation avoidance agreements and in tax havens"** we developed various sides of accounting creativity and its manifestations such as the agreements for avoidance of double taxation or tax havens; we delimited the tax evasion from creative accounting and mentioned the methods of making evasion, but also the measures taken to fight against it, the importance of identification of these practices by the users and delimitation between creativity and illegality, we emphasized the *way in which these techniques can be detected* mainly by those who analyse the financial statements with the purpose of financing a company in the process of evaluating its creditworthiness and to look beyond the numbers presented in the financial statements.

In **chapter 3 entitled *Efficient management in banking system in the conditions of creativity in accounting*** we developed the concept of creditworthiness and the methods of

evaluation of creditworthiness, *the connection between creditworthiness and creative accounting*, the importance of evaluating creditworthiness in the financing process and in management decisions in banking system, the methods of analysis and evaluation of creditworthiness used by the merchant banks and implications of management in banking system in the evaluation process. We wanted to highlight in this chapter the *alarm signals transmitted by the accounting information* in evaluation of performance of company management beyond the numbers presented in the financial reports.

We presented *a few cases of creative accounting which led to disasters* for economic entities, financiers and especially banks, but also banks which resorted to such methods, and last, the *tough lessons learned from the consequences of these customs* with the purpose of serving as examples for those who are of bad faith. We developed in a subchapter the way in which we can fight against the creative accounting techniques, and the way in which they can be discovered in the analysis process of information from financial reports to offer both the management and financial analysts the opportunity to make decisions based on an image which reflects as faithfully as possible the real situation of the analysed entity.

In order to evaluate the importance paid by management from financing institutions and persons involved in the analysis process of the impact of creativity in accounting on the financing decisions and the risks involved, *we carried out an empirical study based on a questionnaire regarding the impact of using creative accounting on the financing decision-making of persons involved in the loan approval flow in financial institutions.*

Conclusions, own contributions, limits and perspectives of research

General conclusions

The purpose of this step carried out in the Accounting Doctoral School was the research from theoretical and practical perspective of the influence of creative accounting on the financing decision of a company by a financial entity. Following the completion of this research, two types of conclusions were drawn: the conclusions drawn after the performance

of the theoretical study and conclusions obtained by realisation of practical studies based on questionnaire.

Conclusions obtained from theoretical study

The first conclusion: creative accounting represents the instrument created for the benefit of managers; it is used for the promotion and support of image of companies they manager and also with the purpose of selecting the information so that the data offered support the pursued interest. Thus, even if the use of creative accounting techniques is not an illegal option, it highlights that, when they are under a financial pressure, managers search for solutions without questioning if they respect the ethical standards. Bu the truth pronounced only by half and the lie could be susceptible of possible fraud.

The existence of options in accounting by virtue of freedom of appreciation and choice allows the managers of a company, depending on the interests pursued or even the inclination for optimism or pessimism, to be tempted to transpose in accounting innovations from legal, financial and economic perspective for which no solutions were found from the perspective of normalization; thus, occasions can be created for manifestation of subjectivity and for creative accounting with effect on the modelling and cosmetization of result or content of financial statements.

These procedures contain a "dose" of accounting creativity and have a subjective nature, they change the content of accounts, but are the result of an option, the choice is made between several methods, which makes us state that they are in the scope of accounting regulations.

If the purpose of creative accounting is assumed to be the improvement of accounts or the image they presented about the company by the opportunity created in this respect by the deficiencies of accounting regulations, we can consider that this concept does not bring anything new, because the principle of options has existed in accounting for a long time.

Creative accounting is a legal practice, can be even an instrument of representation of faithful image when it is used with good faith. But we can prove that it is closer to fraud, if the flexibility from norms is used for the purpose of obtaining certain advantages. Fraud, on the other hand, has nothing creative, it is illegal. The "illegal" techniques are not worth mentioning because mostly such mechanisms have nothing creative, but their knowledge is important for all the users of accounting information. In most cases when the creative

accounting is manifested, the application of accounting policies and the selection of option are in the limits of flexibility of accounting rules and standards.

The way in which the accounting policies are applied is based on the professional reasoning of the person who applies them. In many cases, this reasoning can lead to the prejudice of the results of companies and the financial position reported for them when we deal with an aggressive application of accounting policies which has as result a fraudulent reporting.

When accounting practices exceed certain limits of accounting regulations, the financial reports do not present a faithful image of the company's result and its financial position. In order to decide if we are dealing with a fraudulent report, the intention should be proven. What in the first stage represents an aggressive adoption of accounting policies can be turned later into a fraudulent financial reporting if this approach continues for a longer period of time and has as purpose significant amounts of money. Yet, it is not always easy to identify the moment when the use of creative accounting becomes fraudulent.

The continental concept considers creative accounting as an obstacle to illustration of a faithful image and represents an unwanted deceitful practice; the Anglo-Saxon concept has a certain flexibility and considers that the manifestation of professional reasoning, freedom of choice, judgment is necessary in order to build and present a faithful image. By analysis of the two diametrically opposed perspectives, we can separate what is good from what is harmful in creative accounting and we can understand why there are so divergent opinions of professionals.

In practice the most frequently used creative accounting techniques are those which have the objective of "result optimization" – maximization or minimization of result depending on context and interest. Most of the times the specialised books treat the negative aspect of these techniques which have become a complex phenomenon with worrying effects and the consequences are negative for the users of accounting information, but also for the company who follows these models. Often this game can get out of hand and can reach beyond the legality frontier, which does not remain usually undiscovered even if this happens with delay. There are many companies who reward managers by direct compensations – attractive wages and bonuses – but also indirect rewards – prestige or promotions – all these are based on the financial performance of the company.

Another aspect that must be envisaged regarding the use of creative accounting practices aims at investors – they are provided with wrong information based on which they decide to invest money. The capital markets also use financial information in order to establish the price of securities, investors rely on it in the decision of purchasing, selling or keeping securities. The efficiency of this market depends a lot on the information provided by the capital markets, but if the information is incorrect, as a consequence the markets cannot establish the right price of securities.

Most often, the motivation for which they resort to such practices is the pressure which can come from various directions: the state, shareholders, financiers, investors, etc. The state is an important actor because by its regulatory bodies it disorients companies with unpredictable legislative changes and excessive taxation. There are not few legal changes which came into force a few days after their publication; a few examples could be: widening the scope of application of the unique quota of 16%, increase of VAT to 24%, reduction of VAT to 19% for certain categories of products, appearance of supplementary contributions for the self-employed persons, etc. The pressure can come from investors who pay attention to accounting result and who encourage indirectly its maximisation, but also from business partners, such as customers and suppliers și who are interested that their partner protects the business and does not expose itself to a partner in difficulty so that he tries to mask certain problems to assure the continuity of partnerships.

The pressures coming from the financial creditors are not neglectable. They are interested in the capacity of the company to pay on time their loans and interests with the desire to protect their businesses and not to expose themselves to losses to a partner in difficulty. Thus, often the motivation of using accounting creativity comes from this source by attempting to display a lower indebtedness degree a better capitalization and a higher profitability.

Another weak link is the inaccuracy and interpretability of International Reporting Standards which leads to manifestation of accounting creativity and the overlapping of accounting norms with taxation norms. In spite of an incontestable progress of local accounting regulations, there are many issues to perfect.

One of the objectives of this work was to treat the risks associated with creative accounting practices, to analyse the motivations underlying the use of these practices and to

make the distinction between what is legal and what is not, what is fraud and what is not fraud, what is innovation and what is manipulation. We believe that we fulfilled our objective by treating negative issues related to creative accounting, by debating creative techniques encountered in financial statements, by distinction between creativity and fraud, by detailing the consequences that these practices have on the users of accounting information, and last but not least, by highlighting the reasons behind their use.

Another objective was to highlight the deficiencies of corporate governance systems with impact on the lack of transparency and control regarding the drawing up of financial statements; it is important to understand that the appearance of creative accounting was caused by a poor corporate governance.

Conclusions and recommendations for the case studies

Following the first empirical study we confirm the hypothesis from which we started, that both the auditors and managers and representatives of the financial department consider the regular rotation of the audit company a beneficial thing for maintaining the objectivity of the audit opinion and auditor, 51,09% of respondents had a favourable opinion for the rotation of audit company.

Following the second empirical study, we confirm the hypothesis from which we started by which the creative accounting techniques have a significant impact on the financing process and the decision resulted from this process, 95% of respondents considered that the impact is high or medium.

The impact of creative techniques is substantial, it is important for financiers and for other categories of users to know these techniques and the reasons for which they resort to them so that they can easily identify them and can make decisions based on a faithful image of the economic reality of the companies in question. Once the motivations from which we start in their use are known and understood, the next step is to understand the way in which we can fight against these techniques, when their purpose is to mislead. This was highlighted in a separate subchapter where we highlighted the importance of auditors in detection and mitigation of these risks involved by creative accounting.

Own contributions

Our own contributions in the field of theoretical research relate to the innovative nature of interdisciplinary approach of the studied theme - creative accounting and accounting options analysed from accounting and legislative perspective, the fraud analysed from fiscal and legislative perspective, the creative accounting techniques analysed from the perspective of financial analysis and credit risk analysis. We consider this approach innovative, because the previous studies aimed at a more theoretical approach from legislative and fiscal perspective of the connection of the subject with tax evasion.

Our personal contribution is related both to the accounting area and the financial analysis and credit risk analysis. From accounting point of view, we created a centralised study of creative accounting techniques, and from the point of view of credit risk, we highlighted the way in which the financial indicators based on which the financing decision is issued are influenced by these techniques.

Briefly, our personal contributions consist of:

- Analysis of specialised literature;
- Analysis from another perspective of the creative accounting concept;
- Presentation of the history of this phenomenon of creativity in accounting;
- Presentation of the current stage of research in the field of creative accounting and highlighting the lack of sufficiency in the treatment of this subject.
- Comparative presentation of different perspectives in which the subject of accounting creativity was tackled across time;
- Analysis of the relationship between creative accounting and the illustration of a faithful image
- Highlighting the positive and negative aspects of creative accounting
- Identification of several factors which determine the manifestation of accounting creativity;
- Emphasis of risks and benefits of using creative accounting;
- Emphasis of motivations underlying the use of creative accounting techniques for different categories of users of accounting information;
- Emphasis of impact of corporate governance on creative accounting;

- Presentation of conceptual delimitations regarding the notion of fraud;
- Distinguishing the creative accounting concept from fraud;
- Tracing limits beyond which the creative accounting can be considered fraud
- Presentation of various forms of manifestation of tax evasion;
- Analysis of creative accounting techniques from the perspective of financial analysis and credit risk analysis;
- Approaching the accounting creativity at global level manifested by tax havens and by conventions for avoidance of double taxation;
- Detailed presentation of creative accounting techniques with impact of each technique on the financial reports and on the financial performance indicators and evaluation of creditworthiness;
- Centralised presentation of techniques which have impact on balance sheet and those which have impact on the profit and loss account;
- Creation of a centralization of methods by which the creative accounting techniques can be identified by auditors, financial analysts or other interested Parties;
- Highlighting the role that rotation of audit companies has in maintenance of objectivity, independence of auditors and audit opinion
- Analysis of the role of audit in identification and fight against the negative effects of creative accounting;
- Emphasis in the empirical study carried out on the importance of rotation of audit companies on the objectivity, independence of auditors and audit opinion;

The originality elements are related to:

- the perspective from which the subject of creative accounting was tackled, in light of impact it has on the decisions of managers from banking institutions regarding the financing of analysed economic entities;
- the interdisciplinary connection of accounting with the taxation field, with financial analysis and with credit risk analysis;
- approaching the accounting creativity at company level but also at global economic environment level, in the light of tax haven and the convention for avoidance of double taxation;

- approach from the point of view of management from banking institutions of creative accounting techniques and their importance in the decisions of the bank related to the companies;
- evaluation by managers, financiers and auditors by an empirical study, of the importance of rotation of audit companies;

Limits and future directions of research

It is impossible to conduct a study, however well-substantiated scientifically it may be, without being limited in obtention of research results. This work is no exception from this rule, the empirical research conducted have suffered limitations related to the form, but also limitations related to organisation.

Among the limitations related to form, we mention:

- The interdisciplinary nature of subjects tackled which are related to accounting, taxation or financial analysis; this interconnection on the theme of creative accounting and decisions of management in banking system is not sufficiently treated in the research environment;
- The existence of gaps in specialised literature regarding the impact of creative accounting techniques on the management decisions of persons involved in the financing process in banking system;
- Lack of sufficiency of approaches regarding the need of rotation of audit companies in the fight against the unwanted effects of accounting creativity;
- The short-lived nature of these studies in the light of permanent changes of accounting norms, financial analysis in view of evaluating the creditworthiness for financing purposes, evolution in a fast pace of organisation charts of companies and financial banking institutions which involve changes at level of assignments and decision-making capacity;
- Limitation related to the time needed for completion of answers: we opted for questions formulated as concisely as possible and very short answer variants so that we do not discourage from completion of questionnaires.

Among limitations of organisational nature, we mention:

- The need to allot a longer time to the carrying out of these empirical studies;
- The transmission with a higher frequency of reminders regarding the completion of online questionnaires would have generated a higher response rate by electronic path and thus, the processing of data would have been easier;
- The possibility of travelling physically to many companies and financial institutions would have generated a higher response rate.

Further research perspectives

These limits of this research offer *the perspectives of future research* on the creative accounting theme and impact it has on the decisions of managers from banking institutions regarding an analysed company. Future research could envisage:

- the type of financing institution which makes the financial analysis in view of taking the financing decision;
- identification of techniques which were discovered in the analysis process of creditworthiness with impact of these techniques directly on creditworthiness indicators and implicitly on financing decision;
- creation of a reporting basis of entities who used fraudulent accounting techniques;
- limitation of accounting options or wider development of conditions for application of each available option in the treatment of a certain issue.

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