

The Coordinates of the Creative Accountancy Practices in the Background of the Romanian Economy

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In Romania, where the inflation nucleus is omnipresent and the exchequer taxes are a curse for the development of the enterprises causing a 'leak' in the budget of its substance, the re-treatment techniques of the financial situations have become a 'bridge of despair'. Seen in this background, creative accountancy is the process that manipulates the accounting figures due to the breach existence in the rules, and, by taking advantage of flexibility, those measurement and informational practices are to be chosen thus allowing a change within the synthesis documents from what they should be into what the managers really want them to be, or the process that enables transactions to classify in such a way that they allow getting the accounting outcome desired. By its meaning and effects, using creative accountancy is difficult to be identified. Just as difficult is getting creative monetary situations corrected in the view of some relevant decisions. The main source of information about the making up of the accounts is represented by the accounting politics situation enclosed in the annexes. However, the accountant will never enclose in the annexes the information concerning the fact that he has made use of creative accounting methods or about the way in which these can be traced back.

Key words: creative accounting, fraud, financial manoeuvres, financial auditing, risks

1. Introduction

In a modern society, where the effects of the bankruptcy of a US business may reach as far as an Indian slum, as a result of globalisation - a phenomenon which is more current than ever, the need for the accurate grasp of certain economic concepts is crucial.

Crisis periods are a test for companies, affecting their treasury and generating risks which the accounting department deals with in an imperfect manner. As a result, managers are tempted to resort to resourceful procedures, often debatable, to improve the presentation of accounts. In Romania, the passage from a constant currency to fluctuating exchange rates and the increase of the interest rate correlated to the increasing inflation rate resulted in the increase of uncertainty. Under these circumstances, companies are motivated to adopt risk-reducing instruments. The issue is the delay in the synchronisation between the regulation of the accounting solutions and these instruments.

The inability of historical cost to prove relevant and reliable in inflation conditions also stimulates the use of creative accounting techniques. In practice, in inflation circumstances, the elements in the assets are under evaluated. Some managers opine that in order to compensate the difference between the real value and the historical cost value of the assets, a part of the debts should be hidden. In other words, showing the assets at their actual value would be less prone to triggering "off the balance" financing schemes.

In the past few years, the phenomenon of economic globalization is increasingly talked about. Globalization represents a stage of the internationalization of the companies where the material form of the economic field is subjected to the abstract logic of the capital and information exchange. The exchange of goods and services goes beyond the area of local markets, and the constitution of interest groups has become a superior form of competition. Information and communication technology has dematerialized financial information, providing it with possibilities of quick acquisition, as well as global circulation in real time. However, like any human innovation, it has its disadvantages, viz. increasing the possibility of manoeuvring financial information by manufacturers or suppliers.

As "in the early 21st century the quality and credibility of the financial and accounting information contained in the main accounting books have been questioned by the generalised economic crisis and the financial scandals occurring in big corporations. They have been generated by uncovering forged documents, or by dissimulating techniques of the real situations, phenomena known as creative accounting."

2. Creative accounting between the spirit and the letter of the law

From the very beginning of its existence, mankind was marked by the ominous presence and influence of stealing goods, corruption, or deliberate denaturing of the economic or patrimonial realities. Since the rape of the Sabines by the Romans, the theft of the first born son condemned in the Old Testament, the usury and robbery of another's goods in the old Babylon, the evasion of taxation in Summer and Egypt, the use of counterfeit money and coin mutilation in the Middle Ages, the use of false weights and scales (Cuza's case), to the present-day complex embezzlement schemes, inaccurate financial reports, cyber crimes and banking crimes (of the Enron, Societe Generale, Worldcom, Bernard Madoff type), the common elements have been: theft, fraud, corruption, and evasion.

In specialised literature, the term fraud refers to an intentional action performed by one or more individuals belonging to the management, employees, or third parties, resulting in the denaturing, or erroneous presentation and interpretation of financial reports.

It is worth noticing that the proper meaning of the phrase "financial engineering", viz. main element of any financial system in evolution. And if it is possible to say that the American financial system is still evolving after 200 years of capitalism, then we can surely say that the Romanian financial system is in full progress after only 20 years of existence.

Like any other economic concept, financial engineering has been vividly debated in specialised literature, being defined as the process of combining, dividing, and creating financial instruments to the purpose of achieving highly-profitable illegal financial objectives, within the framework of mostly fiscal legal constraints. Financial engineering is opposed to the financial manipulations and combinations aimed at tax evasion, or depriving an individual of his rightful money, i.e. it is opposed to pseudo-financial engineering.

On the other hand, book engineering is less common in specialised literature, being usually called creative accounting, which has been the topic of vast literature in the past 20 years.

The concept of book engineering is accounted for by the fact that it may be assimilated to the activity of creation, design, research and management of the "technological process" by expert accountants, leading to the "favourable image" desired by the company.

At this conceptual level, book engineering has produced a number of accounting scandals and thus triggered "accounting reforms".

No matter what it may be called, creative accounting or book engineering, it refers to the accounting practices derived from standard accounting practices. They are characterised by excessive complications and creativity similar to writing a novel, to the purpose of creating a favourable image of the financial status or performance of the business. The financial accounts thus obtained are never boring, but have the complexity of a novel, hence the name of "creative" or "innovative".

In this context, one may wonder if fraud and financial or book engineering are synonymous. The answer is definitely negative. Fraud is the ill-intended act which intentionally breaks the law, while creative accounting and financial engineering observe the letter, but not the spirit of the law. The various approaches display a common element, viz. financial engineering is legal and aims at creating a distorted image of the company, presenting it as more prosperous, and thus deceiving the customers.

A survey taken in the U.K. by Naser revealed that 91% of the questioned auditors consider creative accounting as an insoluble issue. In other words, irrespective of the number and the detailing degree in the accounts, there is always a way to "circumvent" the system. As a result, the task of the regulators and the professionals in accounting is not an easy one. Even if they are not sure to win the war against creative accounting, they have to make the effort to beat imagination at its own game."

3. Innovation, imagination, flexibility and manipulation in drawing the financial accounts

The Romanian explanatory dictionary explains the term "creativity" by "skill or ability to create, possessing this skill". It is closely linked to the idea of innovation, which presupposes "the introduction of a novelty or a change in a field or a system".

A short review of specialised literature evinces the lack of agreement in defining creative accounting. As a result, the definition of this concept may start from Trotman's opinion, who sees it as a technique of communication aiming at improving the information given to investors.

This definition of creative accounting is, to our opinion, oversimplified and devoid of essence. In the same vein, but in a more complex form, Colasse considers that the phrase creative accounting designates "practices of accounting information, often placed at the limits of legality, practiced by certain companies who, taking advantage of the statutory limitations, attempt to improve the image of the accounts and the economic and financial performance."

Quoted by professor N. Feleaga, PhD, "Barthes de Ruyter and Gelard place creative accounting in the realm of the imagination of modern financial engineering, which continuously generates new products and combinations whose objective, be it the main one or not, is to circumvent the accounting norms and regulations". This view of creative accounting supports the idea that the possibility to detect financial engineering is limited, and the difficulties are insurmountable.

The most complex definition of creative accounting belongs to Nasser. In his opinion, creative accounting is: "the process whereby, given the existence of loopholes in the rules, the accounts are manipulated, and by taking advantage of flexibility, the selection favours the practices of measurement and information which allow for the transformation of synthetic documents from what they should be into what the managers desire. The process whereby transactions are structured in such a manner so that to allow the desired accounting result."

These elements show that despite the disagreements in defining creative accounting, most researchers accept that it is essentially distinguishable by two aspects:

It presupposes the use of the expert accountants' imagination to translate those legal, economic, and financial innovations which had no regulatory solutions at the moment of their issue;

The combinations resulting from this financial engineering are initiated according to their impact on the accounting balance and the company results.

Most research articles focus on the negative dimensions of creative accounting and its use to deceive the documents' external users. Thus, Griffiths says that "any company modifies its benefits. The public financial documents are drawn on the basis of registers which have been "doctored" in an elegant manner, or downright slashed. The figures shown to the investors have been totally manipulated to protect the guilty."

And yet, Malb and Giot insist that creative accounting should not be automatically assimilated to something negative or evil. Accounting innovations are necessary to keep up with the economic, legal and social evolution. "At its origins, creative accounting is virtuous: it provides accounting with the means allowing it to keep up with the constant development of the markets and the proliferation of financial products. The problem derives from the fact that the instinctive perversity of businessmen quickly sets in."

From our point of view, there should be a clear-cut distinction between the innovative and the vicious part of creative accounting. The innovative part of creative accounting represents the genuine expert accountants' means of answering the normative limitations in force, ensuring evolution as a science, at the same time with the evolution of human society.

As regards the vicious part of creative accounting, it is in fact the background to the simultaneous evolution of the valid norms and the accounting field, being a "necessary evil", as what makes the "dark" part of creative accounting manifest to the detriment of innovation is the psychological factor.

4. Techniques of creative accounting

If it is seen as "a virus, financial fraud may take different forms, from an ordinary theft committed by an employee, to notorious cases, shaking the entire world economy. To combat this "disease", the following data on the fraud should be known: its origin, factors, operating mechanisms, the profile of the wrongdoer, and the injured party."

The techniques of creative accounting may be classified into the following categories:

- *Choosing among various accounting methods.* For instance, in some countries, businesses may choose between the complete registration of the development expenses in the gains and losses account, and their amortisation for the period of the project. The businesses interested in creative accounting choose the specific method which leads to the desired image.
- *Need for estimates or predictions for some elements.* For example, the use duration of a fixed asset, used to calculate the amortisation, is estimated by the company. In other cases, the estimates are made by an external expert. Thus, the accountant may manipulate the value by resorting to an expert known for his/ her optimistic or pessimistic estimates.
- *Making artificial transactions to manipulate the values in the accounting balance or to improve the result.* For instance, this is the case when a fixed asset is sold, and immediately rented for the life duration left. The selling price may be higher or lower than the actual value as the difference may be compensated by rents above or below the market price.

- *Carefully choosing the moment of transactions to obtain a certain image in the accounts.* For example, if the company owns a building purchased with 1.000 monetary units, whose market value is 3.000 monetary units, the management will decide to sell the building in the year when it intends to increase the results.

In practice, the use of creative accounting techniques will have the following effects:

- *Expense increase or decrease.* The accounting regulations leave a certain room in quantifying the expenses of an accounting exercise. For instance, for various assets, only the maximum number of amortisation years is indicated. A longer or shorter duration affects the result. A similar technique may be used in the analysis of provisions and the activation of certain expenses.
- *Revenue increase or decrease.* In certain cases, the acknowledgement of revenues may be expedited or slowed down by applying the caution principle or the connection of expenses to revenues.
- *Asset decrease or increase.* The existence of a certain degree of flexibility in point of amortisation or provisions creates the possibility to increase or decrease the net value of the assets. Also, stocks may be evaluated by various methods and thus their value may be different, with corresponding effects on the loss and gain account. These differences affect the size of the current and non-current assets, as well as the indices calculated on their basis.
- *Increase or decrease of the owners' funds.* The alteration of revenues and expenses affect the value of the result, and thus the reserves. Hence, the value of the owners' fund and all the rates calculated on its basis undergo modifications.
- *Debt increase or decrease.*
- *Reclassification of assets or debts.* Sometimes there may be doubts regarding the inclusion of an element in a certain category. It is the case, for instance, of bonds that may be registered, according to the business' intentions, as current or non-current assets. This classification affects the rates calculated on their basis.
- *Manipulating the information in the annex.* There are certain parts in the annex where more or less information may be included. The lack of important information may affect the decisions of external users.
- *Information presentation.* The criteria used in presenting the accounting information may be a loophole for creativity.

In conclusion, managers, being able to manipulate the result, may maximise their own competence. As a result, it is only reasonable to suppose that the negotiators of the managers' employment contracts anticipate a possible opportunistic behaviour on their part and thus provide lower compensations... Under these circumstances, the managers "accused" of opportunistic acts find themselves "forced" to resort to them to obtain the advantages they have already "paid" for. In turn, the shareholders take advantage of creative accounting as by reducing the results' volatility, the value of their shares increases. Also, the managers' actions in view of avoiding the restrictions in the loan contracts are beneficial to the shareholders.

5. Auditing – a panacea of financial engineering

During economic crises, like the current one, the fraud risk increases. "To an equal extent, the risk of fraudulent financial reporting increases. In this context, when auditing is seen as a "panacea", the financial auditor has to be extra careful in planning and performing his auditing missions."

An important change in point of standards refers to the delineation of the auditor's responsibilities. Thus, if "the initial version of the ISA 240 standard published by the Romanian Chamber of Financial Auditors, entitled "Fraud and error", clearly stated that "The auditor is not and cannot be held responsible for the existence of fraud and errors, but by his/her activity he/she may play a positive role in preventing fraud"; since December 15th 2009, the provisions referring to the auditor's responsibility have undergone a radical transformation, i.e. "an auditor performing an auditing action according to ISA is responsible for the reasonable certainty that the financial accounts taken in their entirety do not contain significant distortions resulting from fraud or error".

According to the new reference law, fraud refers to an intentional act performed by one or more individuals in management, government, personnel or third parties, which involves deceit to the purpose of obtaining an unfair or illegal advantage.

According to the classical fraud theory formulated by Cressey, three fraud premises may be identified, which form the so-called "fraud triangle": opportunity, pressure, and reasoning.

Opportunity refers to the wrongdoer's confidence that he cannot get caught. This confidence may result from the identification of the weak points of the internal control, the inaccurate internal auditing, or from a financial, or even emotional motivation.

Pressure proves to be an extremely potent factor which may be actualised by: the financial needs of the fraud initiator, the need to report superior results to the real company performance, various frustrations at the work place, professional aspirations and the desire to achieve them very fast, a competitive work environment, the mere desire to beat the system, the increase of the managers' bonuses.

Justification: it is surprising to find that in many cases individuals whose professional value and moral integrity have been acknowledged in their field of activity become the "engineers" of fraudulent financial reports. The initiators of such situations feel the need to justify their actions by saying that their actions benefit the company, and they are just a temporary solution, when they have no other option at the time."

Despite his/her efforts, the auditor is subject to the unavoidable risk that certain major errors in the accounts go undetected, even if the auditing is accurately planned and performed.

It is worth remarking that fraud may involve complex schemes, which are carefully orchestrated in order to hide breaches of the law, like forgery, deliberate omissions in registering transactions, or false statements. Such attempts to hide the truth may be difficult to find when they are supported by accessories to the crime. These accessories may deceive the auditor into believing that the auditing evidence is accurate, when in fact it is false.

Moreover, the risk for the auditor to miss a major distortion as a result of management fraud is higher than in the case of personnel fraud, as management is frequently in a position to directly or indirectly manipulate the accounts, to put forward fraudulent financial information or to avoid control procedures aimed at preventing similar frauds from other employees.

In obtaining reasonable certainty, the auditor is responsible for maintaining an attitude of professional scepticism during the entire auditing action, considering the management's potential avoidance of controls, and admitting that the auditing procedures effective in detecting errors may not operate in detecting fraud.

National and international studies, including the regulations of the professional field and our own findings, allow for the comparative analysis between creative accounting and financial fraud.

Table 1. Comparative analysis: creative accounting vs. fraud

<i>Creative accounting</i>	<i>Fraud</i>
It is at the limits of legality.	It is illegal.
It manipulates the accounting truth.	It forges documents to hide the accounting truth.
It obtains benefits without theft, focusing on gathering funds, assets, and other benefits.	It implies asset theft.
It aims at improving the credibility of the business in order to attract investors, financial funds, business partners, and other benefits.	It aims at deception and obtaining considerable illegal advantages.
Processing of economic transactions and events.	Elimination, omission or fictitious registering of financial or economic transactions.
It takes advantage of the permissive character or legislative loopholes leading to areas not covered by express regulations. It deliberately chooses the accounting policies or practices function of a certain interest, established beforehand.	The deliberate erroneous application of accounting practices and techniques, without taking into consideration the accounting principles and conventions, to mislead the users of financial information and the auditing authorities.
It may be a "link" between the economic reality and the accurate image, when applied in good faith; there are cases when, due to the flexibility and action range of professional reasoning, the accountant may generate solutions that are a better reflection of reality than the strict provisions of the law.	It definitely constitutes a harmful financial practice, with a negative impact.

6. From "cooking the books" to major fraud

The book written by professor Paul Ștefanescu, one of the most famous criminologists in Romania, and a renowned specialist in Masonic history, entitled "Major Financial Scandals", creates a portrait of the major confidence games applicable to the analysis of the most important "financial engineering" cases.

The major signs are as follows:

- they are all based on the human innate desire to get rich.
- aggressive media promotion promising the safety of operations (of the type "sleep tight, ...is watching out for you");
- high level corruption;
- bank loans which are never repaid by the debtors;
- blackmail, by corrupting political figures or other influential individuals;
- hiring famous well-paid lawyers well-connected in high circles;
- using false documents;
- appointing influential persons in the administration boards".

All these are a perfect fit to the fraud committed by the US company Enron. In just 15 years Enron had become one of the most important US companies in the energy business, with more than 21,000 employees in 40 countries. On December 3rd 2001, the corporation suddenly went under, although a year before it had announced a profit of over \$100 bn.

What was behind the Enron bankruptcy? The huge losses and the crash of the stock exchange listing led to the revelation that the corporation was a pile of false appearances: a world led by the monetary interests of its managers, where forging documents was seen as "exemplary management".

The Enron scandal started when the Enron company overestimated its benefit, underestimated its debts, and announced a term loss of \$618 million.

In December 2001 Enron was placed under the protection of the bankruptcy law, becoming the most serious failure in US history. Enron used to create false off-shores, transferring its losses to them, without including them in the accounts.

Its brokers lost the entire company as a result of uninspired transactions, and then covered their losses by hiding them and drawing false profit reports, which raised the price of the shares. Enron went under with a total amount of debts of \$31.8 bn, firing 4,000 employees.

The company Lay founded and transformed into a financial empire has become a symbol of corruption, as he was also close to the Bush administration. The company management embezzled billions of US dollars by artificially puffing the accounting balance, the investors being deceived by the pink picture painted by Enron, who was already in deep financial trouble.

One broker managed to embezzle 4.9 bn euros from Societe Generale, the second bank in France. The "hole" is equal to almost half of the assets of the Romanian BRD.

The banking group Societe Generale, the second in France, fell victim to a fraud from one of its brokers, who embezzled 4.9 million euros. Another 2.05 million euros were also lost as asset depreciation during the sub prime credit crisis, which raises the total figure of losses to 6.95 bn euros. This fraud represents almost half of the assets of BRD, the Romanian subsidiary of the French group, and all the assets of the third Romanian bank, Raiffeisen Bank.

Societe Generale traced the fraud to one trader handling the transactions of derivatives on European stock exchanges.

The bank declared that this fraud is unique in amount, and in nature as well. A trader with limited responsibilities engaged in fraudulent investments in 2007 and 2008, going beyond his job description. He managed to hide these investments through a complex scheme of false transactions. The bank announced that these investments would be eliminated as soon as possible, to serve the interests of the shareholders of Societe Generale and to preserve the market integrity. The trader who caused this huge fraud is a 30-year-old man who had worked for Societe Generale since 2002 making less than 100,000 euros/year. When the fraud was revealed, the French bank decided to consolidate its capital by increasing its capital by 5.5 bn euros, being entirely subscribed by JP Morgan and Morgan Stanley.

Nevertheless, Societe Generale obtained a net profit in 2007, despite the huge losses resulting from the fraud, and the provisions covering the potential depreciation of assets, on the background of the credit crisis.

At the level of the Societe Generale group, this fraud only accounts for 0.04% of its assets totalling over 1,000 bn euros administered by the group. This event did not affect the 2007 profit of BRD, and the 9-month profit in 2007 – 209 million euros — showed that the results were in line with the bank strategy.

Despite these losses, the net profit of Societe Generale in 2007 was about 700 million euros, in sharp decrease as compared to the net profit of 5.22 bn euros in 2006. Similarly, despite the 2.05 bn euro asset depreciation, the bank announced that it would not change its dividend policy. Societe Generale is one of the most important financial groups in Europe. Employing over 103,000 people all over the world, the group's activity includes the following areas: the retail bank and financial services (19.8 million customers), asset administration and financial services for investors, an area where the Societe Generale group ranges among the top players in the Euro zone, with more than 1,521 bn euros in custody and 402 bn euros in administration.

The 4.9 bn euro fraud discovered by Societe Generale and committed by one of its traders is a catastrophe for the French banking system.

The announcement of Societe Generale on the size and impact of this fraud took place after several months during which the bank continuously confirmed the solidity of its activities and the reduced risk on the credit markets. One hundred Societe Generale shareholders submitted a complaint to the Paris prosecutor's office for "fraud, breach of confidence, forgery and aiding and abetting a felony".

The BRD shares were not affected by the information on this fraud and went up by 1.52% after the Bucharest Stock Exchange, BVB, stopped the trading of its financial instruments.

The 4.9 bn euro fraud discovered by Societe Generale, the main BRD shareholder, had no impact on the Romanian market.

7. Conclusions

The first measure to be taken to reduce the possibilities of using creative accounting in Romania is the development of a conceptual accounting framework. Such a conceptual framework is first and foremost an instrument at the disposal of regulators. But it is also useful for expert accountants as it allows, through its criteria, the deeper insight into the accounting rules, and the foundation of a clear opinion on accounting practices, and complex operation analysis.

Another measure should target the reduction of the number of allowed accounting operations, or the clear application circumstances for each operation. Moreover, if a company chooses a type of accounting that allows a truthful image for the year in question, it should keep it for the following years. In this respect, progress has been made as the international regulation committee decided on a maximum of two operations for the same type of transactions. IASC recommends the use of reference operation. The companies not meeting the requirements of reference operation are allowed to use the other type of authorised operation. But these companies have to switch to the reference operation as soon as they meet the requirements. The passage from reference operations to the other type of authorised operations would be difficult to account for, and the companies in question would be suspected of opportunist behaviour.

The orientation of external users, especially investors, towards the information of the treasury flow type may discourage managers from using manipulation techniques in their accounting books. Financial imagination may "arrange" revenues and expenses in order to get a higher profit or higher losses.

By its impact and significance, creative accounting is hard to detect. It is equally difficult to correct the accounts that have been creatively drawn, in order to take relevant decisions. Hence, in the fight against "financial engineering" the auditor's possibilities are limited, and the difficulties endless. Nevertheless, the auditing institution is one of the main possibilities to counter fraud, being forced to constantly improve in order to defeat diabolical financial schemes.

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