Laura – Maria POPESCU
Ileana NIȘULESCU,
The Bucharest University of Econimic Studies, Romania

CREATIVE ACCOUNTING VERSUS FRAUD

Empirical study

Keywords
Creative accounting
Fraud
Users
Accounting Information

JEL Classification
M40, M41, M42

Abstract

This article sets out to present the difference between the means of executing creative accountingand that of executing fraud, the way in which they are perceived in the business environment, as well as the implications that they have in companies' activities. The article's structure consists in an analysis of the terms „creative accounting" and „fraud", presenting ideas and definitions that a series of economists have attributed to these terms, the differences between the two concepts, the risks that they imply and the opinion of the business environment regarding the two phenomena. The hypotheses that the article is based on constituted the starting point for a study conducted on the employees of companies operating on Romanian territory. The conclusions confirmed most of the study's hypotheses and the fact that the two terms are often mistaken for one another and, in the opinion of the majority of respondents, constitute reasons for concern with regard to the financial statements submitted by a company.

Introduction

The article approaches the main differences between fraudulent financial reporting and creative accounting, accounting areas that enable creative accounting and fraudulent financial reporting, conducive factors, types of behaviour that may indicate potential fraud, as well as the opinions of people in the business environment with regard to the two phenomena. Accounting scandals, creative accounting and fraud date back to the period when accounting was discovered, the fifth century. Whether it's less developed countries or pioneers of global economics, these problems occur all over the world. The topicality and generalisation of this problem represent the main reason for approaching this research topic. The article's structure consists in analysing the terms of „creative accounting" and „fraud", presenting ideas and definitions that a series of economists have attributed to these terms, the differences between the two concepts, the risks that they imply and the opinion of the business environment with regard to the two phenomena. Creative accounting has been defined as "the art of forging or window dressing a balance sheet", "the art of calculating benefits" (Naser, 1993), "the art of presenting a balance sheet", "the art of creating provisions" being the process through which accounting professionals use their knowledge in order to manipulate the accounting numbers, taking advantage of the possibility of interpreting legislation and the existence of numerous options for solving different accounting issues.

The current state of knowledge

It's often extremely difficult to differentiate between creative accounting and accounting fraud. The necessity of creating a favourable image of economic entities in an ever more unstable and competitive economic environment led to the appearance of creative accounting, a concept that is also known as"cooking the books" or "doctoring financial statements".

In professional literature we find this concept explained by several authors, of which a few definitions are presented in the following lines. Most professional papers present the negative significance of creative accounting and its use for the purpose of misleading the external users of the summary documents. Griffiths states that"any company window dresses its benefits. The published summary documents are drafted based on registers that have been"cooked" in a delicate or not so delicate manner. The numbers presented to investors have been entirely manipulated in order to protect the guilty parties (the managers)."

According to Naeser, creative accounting is ,,the process through which, given the existence of a loophole in the rules, the accounting numbers are manipulated and, taking advantage of the flexibility, one chooses the measurement and disclosure practices that allow them to transform the summary documents from what they should be into what the managers would like them to be" .

Feleagă and Malciu (2002) define creative accounting as:,,the process through which accounting professionals use their knowledge in order to manipulate the figures included in the yearly accounts" .

Despite the fact that the term „creative accounting" is used frequently, there are many contradictions regarding its definition. One of the largely accepted definitions is:„Creative accounting represents using accounting flexibility in order to present and measure the financial statements so that they prioritise those that draft them over the users". (Black's Law Dictionary, 7th edition, 1999, UK).A more ample definition is formulated by economistsMulfordandComiskey: „Creative accounting is any intentional act of distorting the accounting figures and aggressively choosing and applying accounting principles, both within the limits of accepted accounting principles and outside them, as well as fraudulent financial reporting"(Mulford and Comiskey, 2002, USA).

The American definition of creative accounting generally includes the term of „fraud", thus rendering it illegal, while in the UK creative accounting is not seen as an illegal action, but a use of accounting flexibility and excludes fraud. The ideal scenario is that in which the flexibility allowed in accounting is used to the extent to which it can provide users with an accurate image of the financial statements, so that they can make correct economic decisions, such as the decision to buy, sell or keep shares. However, the flexibility of accounting rules opens the door for managers to use creative accounting. From a certain point of view, this is not a bad thing, as it does not break any rule, the problem being that they are straying from the basic purpose of accounting – that of providing users with an accurate image of the accounting data.

Many authors have approached the issue of creative accounting as a synonym of "doctoring financial statements". More recently, creative accounting has been associated with accounting fraud and the lifting of accounts as a method that "stands in the waiting room of fraud" (Ristea – Accounting, management instrument – class notes).

The first record of fraud features two Greek merchants, XenothemisandHegestratos, condemned 360 BCfor acts of deception (Singleton and Singleton, 2010). Later, the discovery of the New World and the mirage of the opportunities offered by the American continent at that time allowed for usury fraud in the railroad field, with the most notorious examples being the cases ofSouth SeaBubble (1717-1720) andMeyer versus

Sfeton(1817). A century later, the famous frauds in the period of the Great Depression(1929-1933): Charles Ponzi andU.S. Postal Service (1920), Samuel Insull(1920-1929), Kreuger& Toll (1929), Securities Exchange Act (1934)occured. Much later, at the start of the twenty-first century, the complexity of embezzlement and inadequate financial reporting schemes in the cases of Enron (2001), WorldCom (2002), ArthurAndersen(2002), SociétéGénérale(2008), Lehman Brothers (2010) or Olympus Corporation (2011) highlighted the role of the financial auditor in the prevention and detection of financial fraud. The experience of these acts revived the interest for learning more about the mechanisms of fraud, the determining factors and the schemes through which fraud can be executed. The necessity of this knowledge that, according to Francis Bacon, represents power in itself,led to the study of financial fraud and determined positive developments in legislation, by adopting laws, standards and protocols that would support the auditor in preventing and detecting its presence at company level.

Accounting specialists are subjected to the pressure of finding solutions to favour and improve the image of entities and adapt to the new requirements that appeared along with the globalisation of businesses and of markets where competitiveness is permanently on the rise.

Research methodology

With regard to the proposed research methodology that was based on bibliographical documentation, the objective was the systemic observation of the phenomenon, followed by the analysis of the data, along with their summary and validation. The thesis combines quantitative and qualitative research, using specific methods, document and content analysis. In order to attain the proposed objectives, a series of bibliographical sources, such as professional literature, accounting, tax and legal regulations, studies and articles published at a national and international level by different bodies operating in this field were used, while the instrument of the quantitative research was the survey.

The purpose of the research was to identify the opinion of persons directly involved in managing the accounting activities of different companies with regard to the two issues being studied. In this regard, one can highlight the similarities and differences between the perceptions of entrepreneurs, managers and accounting professionals as to the two practices, how they perceive the limits of accounting, the way in which they influence the company's activity and their attitude with regard to their use in the relation with the organisation and consumers. The research consists in applying a survey composed of 14 questions to a number of 54 test subjects in order to confirm the presented hypotheses, with the results being processed using the SPSS program. Thus, the survey contains a category of questions with the purpose of identifying the status of the interviewed person within the company, a category that tests their knowledge with regard to creative accounting and fraud, a category of questions meant to detect their attitude with regard to these practices and another one referring to presenting accounting information in relation with its users. The research is conducted on a representative test group, with the subjects being selected from various fields of activity in order for the research to be more trustworthy.

Research results

Delimiting the concept of creative accounting from that of fraud is important. According toDicționarulexplicativromân,the word ,,fraud" is defined as an act of ,,deceit, an act of ill-will perpetrated by a person, usually in order to make a material profit from someone else's rights; theft". Even though creative accounting is based on the objectivity in the professional reasoning of the person drafting the accounting information, which is realised by applying the best policies and accounting options, creative accounting is mostly perceived in a negative way, as a negative creation meant to draft financial statements that correspond to managers' desires with regard to the company's financial position and performance. This way, financial statements are not what they are supposed to be according to legislation, but what management wants them to be. Thus,due to the fact that the creative accounting technique involves procedures of,,doctoring" financial statements without breaking the law, it's not considered an act of fraud.

Practitioner Jameson states that "The accounting process involves operating with different opinions and solving conflicts between them in order to present the results generated by transactions.This kind of flexibility facilitates manipulation, deceit and misrepresentation. These activities, practiced by some of the more unprincipled members of the profession, are starting to be known as creative accounting. Creative accounting does not break the law and accounting rules. It respects their wording, but not their spirit.One could say that the appearance of creative accounting was also influenced by the flexibility of international accounting regulations.Creative accounting is mostly perceived in a negative light (negative creation), meant to lead to the drafting of financial statements that correspond to the managers' wishes with regard to the company's financial position and performance. This way, financial statements are not what they are supposed to be (legal discourse), but what someone wants them to be (interested discourse).

The fact that creative accounting is simultaneously perceived as an instrument for realising accounting interests, as well as doctoring financial statements, is the result of the accounting policies adopted by a company in order to produce and communicate information.

The Accounting Rules according to European Directives, approved by the Ordinance of the Public Finances Ministry no. 1.752/2005 and, later, bythe Ordinance of the Public Finances Ministry no. 3.055/2009, allow one to deviate from the accounting rules if they don't lead to an accurate image of the assets, debts, financial position, profit or loss of the entity. Such deviations from the rules force the entity to use additional information ("additional information must be submitted"), as well as to specify in the explanatory notes the deviations from the rules, the reasons for the deviations and the effect that they had on the entity's assets, debts, financial position, profit or loss. This flexibility in the regulation of accounting also takes into account the fact that accounting truth is not a "reflected"one, but rather a "constructed" one.

On one side, this construction is based on a series of rules and regulations with regard to the classification, acknowledgement, evaluation and processing of the elements in the financial statements and, on the other side, on professional reasoning in selecting the best options. The development of creative accounting, especially the perverted part favoured by loopholes in accounting rules, has direct repercussions, such as the loss of accounting information credibility, especially from investors and financiers. Fraud is an intentional and

Tabel 1

With regard to the methods of executing creative accounting and fraud there is a series of very important specific elements presented in the following table. They highlight the fundamental differences between the two concepts, the more or less negative character of each one and the risks that they involve for the company. When respondents were asked to look at a list and select techniques associated with fraud or creative accounting, one could observe a series of mistakes in their identification, which supports the idea of the lack of an exact delimitation between the two phenomena.

Tabel 2

Based on research conducted on persons in the business environment, a series of opinions regarding the two concepts have been concluded. Thus, most respondents had the tendency to mistake the two concepts for one another, stating that they represented methods of deceiving the users of the financial statements and attributing negative connotations to both creative accounting and fraud. While some respondents only associate fraud with stealing from the company's assets,

alicious activity perpetrated at the expense of clients or investors, be it of civil or criminal nature, at the expense of the company or for its benefit, inside or outside of the company, by managers or non-managers. From the category of frauds perpetrated by managers, financial statement fraud produces the most losses at company level and has the purpose of misrepresenting the financial truth in order to obtain certain advantages or hide certain losses or negative performances. The main schemes, the objective of which is financial statement fraud are caused by inadequate financial reporting and make use of recognizing income in advance, overvaluing assets, undervaluing expenses and debt and, in the case of asset fraud, an important role is played by embezzlement.

Even though creative accounting and fraud mostly occur when the company is experiencing financial difficulties, they are not considered synonymous, creative accounting involves,,doctoring accounting information,a process that is not considered illegal,but certainly does not comply with ethics standards.As for the perception in the business environment with regard to the two research subjects, the opinions are mixed. Based on the research conducted on companies in our country, most people who answered the study's questions are weary of the subject, considering that any deviation from accounting ethics represents a way of deceiving the user of the accounting information. The following table presents the main differences between the two concepts, based on the basic principles, the methods of execution and the impact that they have on the information and the persons involved.

others also perceive it as omitting or hiding information from its users.

One of the main research hypotheses refers to the way in which creative accounting is perceived by persons in the business environment. This is also confirmed by presenting respondents' choices when asked to identify methods of manipulation. This poses the problem of deceiving the user through financial statements based on creative accounting. Most respondents considered that manipulation had the role of attracting financing sources, over 65%, and almost 40 % believe that it doesn't have a negative effect on the companies involved. From the analysis of the answers, one can observe that creative accounting activities are not perceived as deceptive, but rather, as a means of "selling" the company's image by highlighting the positive aspects.

When asked to provide a description of the terms of creative accounting and fraud from their own perspective, most respondents were tempted to only use words such as deception, doctoring, illegal actions, which shows the negative light that creative accounting is viewed in, as a result of the thin line between it and fraud.

Whether based on their motivation, means of execution or purpose, the two activities represent completely different actions on the company and, most times, even the persons involved. From the point of view of similarities, one can highlight: the intention of hiding information from third parties, the critical period in which they are executed, the impact that they have on users and the hidden character of their execution.

Conclusions

Even though creative accounting is based on objectivity in the professional reasoning of the person producing the accounting information, which is realised by applying the best accounting policies and options, creative accounting is usually perceived in a negative light, as a negative creation with regard to the company's financial position and performance. This way, financial statements are not what they are supposed to be according to the regulations, but what the manager wants them to be.

Based on the research conducted on persons in the business environment, a series of opinions with regard to the two concepts were concluded. Thus, most respondents had the tendency to mistake the two activities for one another, stating that they represented ways of deceiving the users of the financial statements and attributing negative connotations to both creative accounting and fraud.

The hypothesis according to which the users of financial statements could be deceived by submitting documents that were altered in order to present a more favourable image of the company is partially confirmed, since a very large number of respondents believed that creative accounting was legal and meant to benefit the company in certain situations.

Even though there are clear differences between creative accounting and fraud, both phenomena occur when the company is experiencing financial difficulties. In the context of the economic crisis, the temptation to make use of the two becomes almost inherent.

Bibliography

[1] Black's Law Dictionary, 7th edition, 1999, UK Dilip, K. S. (2006), 'Creative Accounting in Bangladesh and Global
[2] Feleagă N, Malciu L., Politicişiopţiunicontabile, EdituraEconomică, 2002;
[3] Naser, C. (1993). Creative financial accounting: its nature and use,Pretince Hall, citat de Feleagã N., Malciu L., Politicișiopțiunicontabile, Fair Accounting versus Bad Accounting, EdituraEconomicã, București, 2002;

Table 1.The main differences between creative accounting and fraud

Creative accounting	Fraud
Exploits the imprecise and incomplete character of accounting rules	negative and illegal
If there is more than one way to solve a certain problem, the accountant will choose the one that leads to the result desired by management.	Involves forging or altering accounting records and supporting documents based on which financial statements are drafted
Alters the economic reality without breaching accounting regulations	The erroneous interpretation or intentional omission of events, transactions or other significant information in financial statements.
When used in good faith, represents a necessary instrument for the construction and presentation of an accurate image.	The intentional wrong application of accounting policies associated with the evaluation, acknowledgement, presentation or description of information
Represents a series of techniques for manipulating financial statements, doctoring companies' images in order to make them more attractive to investors or potential investors	Fraudulent financial reporting can be committed as a result of the pressures that the management is subjected to, from inside or outside the company, to attain a predicted profit target.
The techniques and practices provided by creative accounting result in doctoring reality to the limit of credibility, with the purpose of serving certain interests	**Involves actions such as** misrepresentations occurring as a result of fraudulent financial reporting and misrepresentations occurring as a result of asset embezzlement.

Source: created by the author

Table 2.Execution methods

Creative accounting	Fraud
Selecting (or altering) evaluation methods; selecting (or altering) the methods of presenting the summary documents (payment, inventory evaluation);	Forging accounting records or supporting documents based on which the financial statements are drafted
Voluntarily publishing optional summary documents (e.g.financing table);	The inadequate application of accounting policies (overvaluing the current sales amounts);
Establishing information published in the management report	Recording transactions that did not take place(recording fictional transactions);
Establishing the volume and degree of aggregation of the information published in the summary documents, especially in the annex	Destroying or omitting records or documents referring to transaction results
Selecting (or changing) the auditor; observing (partially or entirely) the international accounting regulations or the acknowledged international accounting regulations	Asset misappropriation (theft or abuse of assets belonging to the entity, such as hiding sales, fraudulent invoicing, fraudulent payments.
Establishing the date for the communication of the financial information	
Abandoning certain accounting principles	

Source: created by the author