# CREATIVE ACCOUNTING FROM TRUE AND FAIR VIEW TO FISCAL FRAUD

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**Abstract:** In compliance with its objective, accounting endeavours to provide information about the financial status, performance and progress of a company, and to furnish all those concerned with a true and fair view of an enterprise patrimony. Being creative in the field of accounting expresses a professional's freedom to use the means which allow them to describe enterprise economic facts, whereas being conventional imposes the observance of rules set up by accounting laws. Creative accounting is not an illicit practice although its being moral and ethical still raises questions.

**JEL classification: M21, M41**

**Key words: creative accounting; creative accounting techniques; true and fair view; fiscal fraud; financial statement**

## 1. INTRODUCTION

Creative accountancy involves accounting professionals' use of imagination to explain the juridical, economic and financial innovations which at the time of their emergence do not have normalized accounting solutions. Yet, one should not ignore that under the IAS andIFRS implementation the ingenuity of accounting professionals is real only if the usefulness and credibility of financial statements are not affected as far as investors or other categories of users are concerned. Although this practice obeys the law, it deliberately misleads the users of financial data thus making up a distorted picture of a company. Nowadays, creative accountancy has become a complex, evolutional phenomenon with alarming effects to the specialists in the field.

## 2. RELATIONSHIP AMONG TRUE AND FAIR VIEW, CREATIVE ACCOUNTANCY AND FISCAL FRAUD

The creative accountancy concept is generally used to describe the process by which accounting professionals utilize their knowledge for the purpose of controlling the numbers they include in annual accounts.

Most substantial definition belongs to Naser (1993:59). Therefore, creative accounting is: „1) the process by which, since there are rule breaches, accounting figures are manipulated and, thanks to flexibility, assessment and information practices are selected which allow the transformation of financial circumstances from what they should be into what managers would like them to be; 2) the process by which transactions are made up so that to allow the generation of the desired accounting outcome."

The continental accounting system generally looks upon creative accounting as an impediment to achieving a true and fair view, because it is an unwanted, deceiving practice, whereas the Anglo-Saxon system proves much more flexible and thinks of creative accounting as being necessary in order to keep up with economic, social, or juridical growth.

The concept of true and fair view is of British origin. Having tried to define the concept of true and fair view, Lee (1981) asserted: “Nowadays, true and fair view has become a term used in arts. It supposes the provision of accounts set up in accordance with generally accepted accounting principles, the use of very precise figures, the accomplishment of reasonable assessments, and their adjustment in such a manner that irrespective of current accounting practices’ limits the most objective view could be supplied, with no significant errors, alterations, influences or omissions. In other words, the content and operation of the law must be taken into account”.

The term true and fair view is one of the most controversial accounting notions. The different approaches of related aspects lie at the core of the major perspective differences between the two great accountancy trends: Anglo-Saxon accountancy and French accountancy.

The basic difference is that in French accountancy just like in the accountancy of most continental European countries, a true and fair view is a goal whereas in Anglo-Saxon tradition states it means an accounting principle, namely a primary principle that contributes in fulfilling this goal.

As to the relativity of the true and fair view notion, Michel Capron (1994:58) stated: “It is now admitted that there can be several true and fair views of the same reality as there can be several photographic presentations of the same object according to the angle from where it is viewed, to light, distance etc. And therefore one should choose what is most lawful and compliant with the given circumstances and additionally, since accountancy can only provide a single reality presentation, the matter arises not to take a view for reality, to be perfectly aware of the gap existing between the two and not to fall into the trap of dangerous illusions as is the case with the users that do not have prior accounting training.”

Differently approaching the notion of true and fair view is also generated by the ratio between accountancy and fiscality. Thus, in the countries of Anglo-Saxon tradition where accountancy has been successfully disconnected from fiscality, the only reason of synthesis documents is to provide a true and fair view on a financial statement and inventory in compliance with true facts. Financial accountancy is still connected to fiscality in the countries on the European continent. Under these circumstances, enterprises in their annual financial statements will try to enjoy as many fiscal benefits as possible, often to the detriment of economic reality.

The Romanian accounting system which has been strongly influenced by the French one and a little by the Anglo-Saxon one is still very far from the requirements of meeting the goal of a true and fair view.

The fiscal fraud term is the behaviour of taxpayers when flagrantly infringing the law for the purpose of avoiding the payment of anytaxes, fees, charges, amounts they owe to the State budget.

Whether it takes place by dissimulating a taxable subject, underestimate taxable materials or by any other means of avoiding tax payment, the common denominator for such facts is the deliberate infringement of fiscal regulations in order to escape from accomplishing one’s legal obligations. In terms of the relationship between creative accountancy and fiscal frauds, E. Dinga (2008:33) stated the following: ”As long as creative accountancy is correct, namely it does nothing but intelligently exploit the gaps or inaccuracies in tax laws, one cannot speak of fiscal fraud. The moment tax laws were obviously infringed, one could certainly speak of fiscal fraud, too. Consequently, things happen as in the so-called honest accountancy: as long as fiscal laws are not broken, one cannot speak of fiscal fraud."

## 3. CREATIVE ACCOUNTANCY TECHNIQUES

The main techniques of creative accountancy used in companies can be ranked as follows:

- creative accountancy techniques referring to fixed assets generally mean the accounting approach of development expenses (capitalization or expensing), goodwill, assets' revaluation, sale and redemption of assets, policy of depreciation and entry of impairment adjustments, capitalization of expenses subsequent to assets' placing in service, lease-back operation, artificial transfer of capital assets;
- creative accountancy related to current assets is present in the following directions: stock inventory, amount of stored production, choice of bookkeeping method for construction contracts, artificial transfer of placement securities, calculation and entry of stocks and receivables impairment depreciation, presence of circular deals, reclassification of placement securities within the category of tangible assets and vice versa etc.
- the creative accountancy techniques mentioned above also influence owner's equity or debts. In addition, the creative accountancy techniques related toowner's equity and debts also include: the way of using share premiums, provisions policy, externally contracted manpower, sales of goods followed by goods return etc.

The following are three case studies concerning creative accountancy techniques.

**Example 1: Creative accountancy techniques referring to development costs**

The distinction between development costs and research costs creates the prerequisites for the manifestation of creative accountancy. Thus, an entity which uses a policy of development costs' capitalization may increase or decrease the earnings of a financial year by merely regrouping them into the research category which means there is an impact upon its profit and loss account, or into the development category which affects its balance sheet. Moreover, the entity may always claim uncertainties about project completion in order to transfer balance sheet development costs to its profit and loss account (Feleagă and Malciu, 2002, p. 399).

Let us suppose a company accomplishes a research and development project which generates expenses of 3,000 Lei in year N and 4,000 Lei in year N+1. The project-led revenues emerge in years N+2 and N+3 and reach 5,500 Lei/year. It is assumed that company revenues except those that are project generated amount to 20,000 Lei/year.

The entity can choose one of the following accounting approaches:

- development costs' capitalization during the years they were made and their depreciation in years 3 and 4 when economic benefits emerge;
- development costs' capitalization in year 1 and their transfer into the profit and loss account in the end of year 2 as a result of some uncertainties about project completion;

- ranking all costs into the research category.

The effect of the three approaches upon the profit and loss account during the four years is shown in the table below:

**Table no. 1**

| | Year N | Year N+1 | Year N+2 | Year N+3 | Total |
|---|---|---|---|---|---|
| **Approach 1** | | | | | |
| Revenues | 20,000 | 20,000 | 20,000 | 20,000 | **80,000** |
| Project revenues | 0 | 0 | 5,500 | 5,500 | **11,000** |
| Depreciation expenses | 0 | 0 | (3,500) | (3,500) | **(7,000)** |
| **Accounting result** | **20,000** | **20,000** | **22,000** | **22,000** | **84,000** |
| **Approach 2** | | | | | |
| Revenues | 20,000 | 20,000 | 20,000 | 20,000 | **80,000** |
| Project revenues | 0 | 0 | 5,500 | 5,500 | **11,000** |
| Depreciation expenses | 0 | (3,000) | 0 | 0 | **(3,000)** |
| Research costs | 0 | (4,000) | 0 | 0 | **(4,000)** |
| **Accounting result** | **20,000** | **13,000** | **25,500** | **25,500** | **84,000** |
| **Approach 3** | | | | | |
| Revenues | 20,000 | 20,000 | 20,000 | 20,000 | **80,000** |
| Project revenues | 0 | 0 | 5,500 | 5,500 | **11,000** |
| Research costs | (3,000) | (4,000) | 0 | 0 | **(7,000)** |
| **Accounting result** | **17,000** | **16,000** | **25,500** | **25,500** | **84,000** |

Note: The amounts in brackets are minus.

**Example 2 - Creative accountancy techniques referring to production amount**

Between January and November, a productive business organization achieved a turnover of 8,400 Lei/month with material costs of 2,550 Lei/month, employment charges of 3,000 Lei/month, and depreciation expenses of 950 Lei/month. There are no production orders in December.

Under these circumstances, the company management has two options:

- the former is not to accomplish production in December, but to pay salaries;
- thelatter is to produce the goods for a market where there is no demand yet.

According to the decision made, the profit and loss account during the entire financial year is the following:

**Table no. 2**

| | Option 1 | Option 2 |
|---|---|---|
| Turnover | 92,400 | 92,400 |
| Stored production | 0 | 6,500 |
| Material costs | (28,050) | (30,600) |
| Employment charges | (36,000) | (36,000) |
| Depreciation expenses | (11,400) | (11,400) |
| **Operating profit** | **16,950** | **20,900** |

The decision to continue production although it has no immediate end allows the company to hide lower performance costs and make a convenient profit. Of course, there is the risk for the market not to accept these goods unless they rely on a firm order and therefore to turn into loss during the next period.

**Example 3 - Creative accountancy techniques referring to construction contracts**

Two bookkeeping methods may apply to longer-term construction contracts: the method of development percentage which means the contract revenues and costs are acknowledged according to the works' completion percentage during each tax year which leads to the benefit allocation per tax year, and the method applied once the works have completed which means the earnings are acknowledged only when construction works are over.

Let us assume a contract of 2,000,000 Lei whose completion requires two years and involves total estimatedexpenses of 1,500,000 Lei. During year 1, the current expenses amount to 800,000 Lei and it is estimated that contract completion should require another 2,750,000 Lei. During year 2, the actual expenses amount to 720,000 Lei and the contract is completed.

As it has been mentioned, there are two bookkeeping methods for construction contracts. Next, this application is solved by the method of development percentage. The percentage of works completion is the ratio between the actual expenses and the revised total expenses needed to carry out the project. The completion percentage is not calculated during the last year as the revenues are settled by the difference between contract value (revised if necessary) and the amounts charged during the previous years.

**Table no. 3**

| No. | Elements | Year 1 | Year 2 |
|---|---|---|---|
| 1 | Current expenses | 800,000 | 720,000 |
| 2 | Total estimated expenses for project completion | 1,550,000 | 1,520,000 |
| 3 | Project completion percentage (rd.1/rd.2) | 51.6% | |
| 4 | Total contract value | 2,000,000 | 2,000,000 |
| 5 | Subsidies from works and services | 1,032,000 | 968,000 |
| 6 | **Gross earnings (rd.5 – rd.1)** | **232,000** | **248,000** |

In the event of using the method at works' completion, the result shall be acknowledged only when construction works have completed and until then the amount of actual costs shall be acknowledged as an activity in progress.

**Table no. 4**

| No. | Elements | Year 1 | Year 2 |
|---|---|---|---|
| 1 | Current expenses | 800,000 | 720,000 |
| 2 | Revenues associated with costs of services in progress | 800,000 | -800,000 |
| 3 | Subsidies from works and services | 0 | 2,000,000 |
| 4 | **Gross earnings (rd. 2 + rd. 3 - rd.1)** | **0** | **480,000** |

According to each company's goal of minimizing or maximizing its earnings, either of the two methods shall be used in order to bookkeepconstruction contracts.

## 4. CONCLUSIONS

Creative accountancy is not illegal, but managers under stressful financial circumstances look for solutions without considering ethical standards and therefore half a truth is not a lie, yet it cannot be full truth either.

Whereas creative accountancy involves accounting manipulation on the edge of legal regulations, frauds refer to accounting manipulation that is outside the limits of the law.

Consequently, it cannot be stated that fraud and creative accounting are absolutely synonymous. Both are deliberate actions, yet the latter generally obeys the law, not the operation of the law. Creative accounting is legal, it can even be a factor that helps reach a true and fair view when it is applied with good intentions. At the same time, it can also be proven that it is closer to fraud if regulations' loopholes are used to get some advantages for certain users of accounting information to the detriment of others.

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