FROM CREATIVE TO FRAUD ACCOUNTING

Lica ERHAN, lica.erhan@mail.ru,
Victoria VRABIE, v.victoria486@gmail.com
Gloria BURLACU, burlacugloria@gmail.com
Marina SFECLĂ, sfecla.marina@gmail.com
Academy of Economic Studies of Moldova

Abstract. *The aim of this article is to explain the differences between creative accounting and fraud, because creative accounting does not mean necessarily breach accounting rules and regulations, but it can be done well within the law. Also, should be understood where is the border between those two concepts, because the line is very thin and economic agents may meet a lot of problems because of this misunderstanding.*

Keywords*: creative accounting, fraud accounting, accounting options and policies.*
JEL: *M41; F30.*

Introduction

Accounting is a very complex concept and can be seen as a science, technique, historic phenomena, art or even as a social game. As people become more familiar with accounting science each of them prefers that aspect of accounting that fit more their essence: rigorous prefers accounting science and technology, creative prefer art, and gamblers, social games. At this moment appears an outline between fair accounting and „bad" accounting. The presence of different accounting policies and options gives the possibility to the appearance of creative accounting.

In conditions of an uncertain and unstable economic environment, entities are forced to be a little creative in order to survive, because each entity seeks to achieve its own goals, but they are often overshadowed by the external pressure. The biggest pressure comes from the state (through unpredictable legislation and excessive taxation); investors (due to the excessive importance they give to the accounting result); commercial and social partners (their interest is higher wages and job security) or even bank lenders (through maturities).

Despite the fact that creative accounting has been the subject of numerous articles and scientific papers over the last forty years, creative accounting practices have continued to create controversy so far, without reaching a common point in defining the concept of creative accounting. Polemics in relation to the concept of creativity in relation to accounting are in the area of "fair accounting versus fraud".

Breaking Down Creative Accounting and Fraud

As previously debated, creative accounting stands for the tactical and applied approach of using the flexibility given by the regulatory accounting framework to manage the way a firm`s performance is measured and presented to the main stakeholders as it would serve to the direct interest of the users. Fraud, on the other hand represents the process of deliberately stepping out of the regulatory framework that will result in a false general picture of the accounts and in giving an eronate perception over the current state of the business.

Table 1. Differences between Creative and Fraud Accounting

Creative Accounting	Fraud Accounting
Using the flexibility given by the laws and regulations.	Manipulation or „improvement" of the documents.
Structuring the transactions so that the result would be the one that is wanted.	Intentional omission of some registered transactions or registering transaction without a purpose for covering the actual financial situation.
True and fair view obtained through flexible interpretation of the law	Inappropriate allocation of some assets that can negatively influence the Financial statements
Accounting as a social, technical, intellectual game	Distortion or theft of the assets

Source: *created by the author based on reference number 2.*

Although the differences are more than evident, there is just a fine line that may define the stepping from one another. Thus, there are clear stages that can distinguish the terms:

- Firstly, the regulatory framework can be perceived as rigid and eliminating the accounting choices.
- Secondly, working within regulatory framework to ensure users` interests, by using the flexibility to give a "true and fair view".
- Thirdly, keeping tight to working within the framework given by the laws and regulations, to serve preparers interests while approaching a creative view.
- Finally, crossing the barrier of regulatory frame and working outside it, thus expressing a fraudulent view is already transforming the process into fraud, which is prohibited and punished in correspondence to national specifics of the available regulation.

Main methods of using the Creative Accounting relied on:

- Increasing income (by earlier recognition of sales);
- Decreasing expenses (capitalization of interest, provision account);
- Increasing assets (technique of assets` evaluation, enhance goodwill);
- Decreasing liabilities (extra-balance sheet financing, classifying debt as equity);
- Adjusting depreciation costs;
- Undervaluation and overvaluation of profits;
- Leasing and lease-back;
- Playing with the different degree of flexibility given by the National Accounting Standards and International Financial Reporting Standards.

Main methods of proceeding to Fraud:

- Misappropriation of assets (through theft of the cash or inventory);
- Fictive transactions (fraudulent sales, inexistent contracts).

Accounting alternatives, policies and forecasts are the main instruments that can be undertaken by the accounting professionals in introduction of the creative accounting techniques. The modern society and the existing relations formed between the main economic stakeholders have reached a high level of complexity, thus, the regulatory framework is not able anymore to ensure and impose a mandatory, unique solution.

Creative accounting represents the result of the existence of flexibility among the accounting normative framework. If this flexibility is responsible used then it reflects a picture of the reality. Contrary, creative accounting is transformed into fraud, and somehow this is how mistakenly it is generally perceived in our society. This fact is due to the intrinsic human characteristics that tend to interpret and apply decisions mainly for the personal interests and for the sake of immoral and unjust benefits.

Other important aspects to be considered are the National Accounting Standards and the International Financial Reporting Standards that might as well not only influence the financial result of the company but the reliability and coherence of the information.

Table 2. Differences between International Financial Reporting Standards and National Accounting Standards

Analyzed problem	IFRS	NAS
✦ **The recognition of intangible assets**	There is no legal limit, entities have the opportunity to designate by themselves a limit (by utility criterion, more than one year)	For fixed assets typically is applied the ceiling set by tax legislation.
✦ **Depreciation of tangible assets**	*Useful economic life*: estimation of useful economic life is based on professional reasoning by the entity's experts. *Depreciation method*: the choice of the depreciation method is based on professional reasoning *Residual value* is determined on the basis of professional judgment and may be revised.	There are similar rules regarding depreciation of fixed assets. However, the NAS provides more detailed requirements on depreciation, for example, depreciation is calculated from the date of transmission in use or the first day of the month following the month of transmission

Analyzed problem	IFRS	NAS
✦ **Devaluation of assets**	Assets are tested for devaluation if there are indications of devaluation. According to IAS 16, devaluation losses can be determined at asset level or at the level of a cash-generating unit by comparing the net book value with recoverable amount.	According to NAS, "Devaluation of Assets", devaluation losses are determined by comparing the accounting value with the fair value less costs of selling an asset or group of assets.
✦ **Revaluation of tangible assets**	Revaluation is allowed, but not required. It will be carried out whenever necessary on the basis of professional reasoning. If the decision of revaluation of a tangible items is taken then the entire class of tangible assets to which the item is belongs shall be revaluated.	The subsequent assessment of the tangible assets may be performed based on the valuation model stipulated in IAS 16, if that model is included in accounting policies.
✦ **Evaluation of intangible assets**	Cost based model: ✐ an intangible assets has to be accounted at its cost less any cumulative depreciation and any accumulated impairment losses (IAS 38.74). Revaluation model: ✐ an intangible asset has to be accounted at a revalued amount that represents its fair value at the revaluation date less any subsequent cumulative depreciation and any subsequent accumulated impairment losses(IAS 38.75).	After initial recognition intangible assets are measured at their accounting value (at cost). Subsequent appraisal of the intangible assets may be performed based on the revaluation model specified in IAS 38, if that model is included in accounting policies
✦ **Exchange of the assets**	The evaluation of the received fixed assets is done at the real value with the exception of the situations where the exchange transaction does not possess commercial characteristics or the real value of the received asset, nor of the off-set asset cannot be determined.	The exchange of the assets represents the registration of two distinct operations, the alienation of the asset used for the change and the acquisition of the received asset.
✦ **Stocks**	An entity can purchase stocks in conditions of differed settlement terms. If the commitment actually contains a financing element, that element, for example, a difference between the purchase price under normal lending conditions and the amount paid, is recognized as an expense with interest over the period.	The national regulation does not contain specific requirements for the separation of the cost of financing for purchases under deferred settlement terms.
✦ **Spare parts and equipment of major importance**	Items such as spare parts, safety and service equipment will be recognized in accordance with IAS 16 when they correspond to the definition of fixed tangible assets. Otherwise, these items are classified as stock.	The notion of spare parts, security and service equipment is not defined.

Source: *reference number 1.*

As a bottom line, creative accounting can go right till the barrier of legacy and fraud, although respecting the regulations as it impacts the real users of accounting information and has a direct correlation to the economic decisions that follow on its basis.

Example 1. *In order to understand how creative accounting works the example bellow it is suggested. Consider a company with the following Balance Sheet.*

Assets	Sum (mln MDL)	Owner's Equity and Liability	Sum (mln MDL)
Inventory	20	Equity	10
		Profit	10
Total	20	Total	20

The company could:

(1) Adopt a more generous inventory valuation policy, perhaps by lowering the provisions for obsolete Inventory. Thus, the amount for the Inventory would increase by 1 mln MDL.

(2) Do a particularly rigorous stock-take that would result in a raise by 0.5 mln MDL.

Hence, the Balance sheet of the company would be like:

Assets	Sum (mln MDL)	Owner's Equity and Liability	Sum (mln MDL)
Inventory	21,5	Equity	10
		Profit	11,5
Total	21,5	Total	21,5

As one can observe we have increased the Profit of the company by 1.5 mln MDL.

Throughout the history, there were countless cases of major companies that have crossed the thin line between creative accounting and Fraud. Some large-scale cases are Saytam Scandal, Lehman Brothers Scandal, Tyco Scandal, and Enron Scandal.

Table 3. Brief description of the accounting scandals

Company	Industry	Main Players	How they did it?	What Happened?	How they got caught?
Enron	Commodities, energy and service corporation.	CEO and former CEO	Kept huge debts off the balance sheet	Shareholders lost $74 bln, thousands of employees and investors lost their retirement accounts.	Turned in by internal whistleblower.
Lehman Brothers	Global Financial services firm	Lehman Executives and auditors, Ernst & Young	Allegedly, sold toxic assets to Cayman Island thus gained $ 50 bln cash.	The company hid over $ 50 bln in loans disguised as sales.	The company went bankrupt
Tyco	Blue-chip Swiss security systems company	CEO and CFO	Siphoned money through unapproved loans and fraudulent stock sales.	CEO and CFO stole a $ 150 mln and inflated company income $ 500 mln	SEC investigation

Source: *reference number 5.*

Conclusion

Creative accounting will exist for as long as there are professional accountants who are capable of doing "fireworks" through which the entity can improve, apparently, its performance. Accounting practitioners and managers have begun to understand the importance of designing and substantiating creative accounting policies in the current context of the domestic accounting system with harmonization with EU Directives and the IFRS reference. Nowadays, the accounting policies selected by the entity's management represent a true strategic decision for the entity. Accountants and other financial specialists should join the field of accounting policies and options and together they will be able to conquer the business world.

It is worth mentioning that the creative techniques for modeling the balance sheet and information contained in the financial statements do not represent any legal deviation, since the management of the entity has a certain freedom in the choice of accounting methods for transactions and economic phenomena. The issue of creative accounting includes a series of controversies, widely debated in the international literature, which mainly targets some of the stricter changes in accounting standards. At the same time, the existence of a stricter regulatory framework leads to the fact that entities will find the ways to minimize its impact, because as many rules as possible would not be implemented, the creative accountant will always find a privileged field for creative accounting methods and techniques.

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