

CREATIVE ACCOUNTING AND THE ILLUSION OF CORPORATE PROFITABILITY: TECHNIQUES, MOTIVATIONS, AND REGULATORY CHALLENGES

CONTABILITATEA CREATIVĂ ȘI ILUZIA PROFITABILITĂȚII CORPORATIVE: TEHNICI, MOTIVAȚII ȘI PROVOCĂRI DE REGLEMENTARE

ZAMISNÎI Carolina, studentă, specialitate: EMREI

Academia de Studii Economice din Moldova, Republica Moldova,
Chișinău, str. Bănulescu-Bodoni 61, www.ase.md

Telefon: +37360477822

e-mail autor: carolina.zamisnii@ase.md

Abstract: *Creativitatea în contabilitate se conturează ca un spațiu ambiguu între flexibilitate legitimă și potențială distorsionare a realității economice, unde problema centrală nu este existența libertății de interpretare, ci modul în care aceasta este utilizată. Din perspectivă etică, delimitarea dintre optimizare și manipulare este dificil de trasat, deoarece multe practici rămân formal conforme, dar problematică devine intenția din spatele lor. În același timp, o abordare excesiv de conservatoare poate distorsiona în sens opus realitatea, ceea ce evidențiază faptul că etica nu înseamnă doar evitarea exagerării, ci și menținerea unui echilibru între prudență și relevanță. În acest context, responsabilitatea profesională capătă un rol central, depășind simpla conformitate legală, iar acest articol are intenția de a analiza integritatea, transparența și respectarea substanței economice ca criterii definitorii ale unei raportări corecte.*

Cuvinte cheie: contabilitatea creativă, fraude, IFRS, standarde, profitabilitate

JEL CLASSIFICATION: H32, K22, M41, M42, M48.

INTRODUCTION

Although many may argue that in the 21st century the new generations have recentered their values and now the trend for spirituality and immateriality has taken an upward turn, it is undeniable that in the corporate world the goal is very much unchanged, it being the profit-maximization. This being said, there are a plethora of determinants that can influence both the short and long term earnings, and for what is worth, one of them is the art of strategic use of creative accounting practices. The fierce competition on the oversaturated markets makes the fundraising more challenging, thereby, fearing the loss of investors and lenders, managers often opt for exploiting the loopholes of the legal regulations and standards, in order to simulate a stronger financial position for preserving the company's image.

CORE CONTENT

The pressure is often driven by the need to satisfy the shareholders, too, as sustaining a positive stock price performance on the financial market is crucial, and by implementing techniques of creative accounting, the financial statements, which are essential tools that help identify opportunities for growth, assess the revenue patterns and demonstrate financial legitimacy, can be manipulated strategically. Bookkeeping can both adhere to the legal frameworks, and distort the balance sheet, the income statement, and the cash flow; and the created apparent transparency can be both optimizing and dangerous for the entity's trustworthiness. The boundary between what is accepted as a loophole, and what is seen as a fraudulent misrepresentation, is blurred, however, often the issue being defined by what is deemed ethical and what isn't. And as the main quandary hides in the delicate distinction between legitimate creative accounting and outright fraud, it is fundamental for the concept of creative accounting to be explained thoroughly. At its core, creative accounting

refers to the use of judgment within accounting standards to present financial information in a manner that may be formally compliant yet strategically misleading. While accounting frameworks developed by institutions, such as the International Financial Reporting Standards Foundation and the Financial Accounting Standards Board, aim to ensure transparency and comparability, they inevitably allow for discretion in areas such as valuation, timing, and classification. This discretion creates space for the construction of an “illusion of profitability”, though when the once optimizing methods become systematically used to mold the reported outcomes into the desired models, without them reflecting the underlying economic substance, the practices shift towards deception. The legal accounting dimensions allow for a certain level of autonomy, like firms choosing independently the methods for depreciation calculation, but the techniques employed show how flexibility can be exploited in either good faith or with the intent to mislead. And because this ambiguity is hard to both acquit and convict, the creative accounting is difficult to regulate and prone to be abused. (Ekonomski Vjesnik, 2018)

Throughout history there have been registered several schemes of creative accounting implementation, and by analysing how nations manage to detect the loopholes in their jurisdictions, can be concluded that different states prioritize different approaches towards financial reporting. For instance, in the United States, where accounting standards are governed by the Financial Accounting Standards Board, firms have historically relied on complex financial structures, such as special purpose entities, to manage liabilities off the balance sheet. A similar strategy to obscure debt and inflate reported profitability was popular in Japan, too, around 1980s, called the Tobashi scheme, it involving the sale, swap or other form of temporary trade of a liability of one company with another company within the holding's portfolio, often solely created to conceal losses of the first firm.

Even though the Japanese government has eventually introduced harsher civil laws that officially criminalized those practices, there still were registered collapses of giant international companies that now serve as a dark example for all accountants and managers that are tempted to take the schemes too far. Before its downfall, Enron was widely considered a major corporate powerhouse. According to FBI, the collapse of this energy company in December 2001 has precipitated what would become the most complex white-collar crime investigation in the FBI's history. Based in Hudson, Enron has once boosted revenues over 150 billion USD, but after it has cheated investors to enrich themselves, the price of its shares went from \$90.75 at its peak to \$0.26 at bankruptcy, affecting over 20,000 employees and shacking the entire Wall Street like a thunder. In 4 years prior its demise, the shareholders were reported to lose up to 74 billion USD, and up to this day, it is the most popular scandal related to the malevolent use of creative accounting. (FBI, 2016)

Following the statements of analysts that worked on this case, the fraud was based both of on the implementation of the Tobashi scheme, Lehman Brothers' Repo 105 scheme and the classical over-assessment of assets, however, another popular technique in the creative accounting field is the manipulation of the revenue recognition. Earnings management occurs when managers use their discretion in financial reporting or in structuring transactions to change how financial results appear. The goal is usually to influence how stakeholders interpret the company's performance or to affect outcomes tied to accounting figures, such as contracts or bonuses. In this way, reported numbers may still follow formal rules but no longer reflect the actual economic position. (Investopedia, 2026)

Similarly, there exists an illicit financial operation, used mainly in the United States, where participants in the gross revenue stay unaffected but profit participants are presented with a deflated or negative number on profitability in order to minimize the wage payment, this being known as the Hollywood accounting. Although extremely unethical, history, unfortunately, has recorded many cases when different studios have mistreated several actors and actresses, including the Star Wars' Darth Vader actor – David Prowse, whose gross earnings were adjusted with 729 million USD.

In addition, more sophisticated mechanisms involve offshoring and tax avoidance strategies, where profits are shifted to low-tax jurisdictions through transfer pricing or complex corporate structures. For implementing the technique of a “minimum-profit accounting”, the Offshore

Financial Centers are a popular instrument for multinational corporations to maximize the profits, as there they are charged with a lower tax bill. The movement of the capital across borders can be in the form of dividends, royalties, donations and interests, as these channels often provide greater opportunities to exploit the legislation loopholes. A well thought strategy can reduce the tax rate, for example from 35% to 15%-25% or lower, depending on the OFC. In 2014, according to the European Commission, thanks to a combination of subsidiaries in Ireland, the Netherlands and Bermuda, Apple managed to reduce its tax payments to a striking 0.005%, as the profits are not accounted for where the economic activities take place. Having this, a natural curiosity might arise in regard to the definition of the OFC and the list of countries that can be listed as such. IMF, OECD and other international organisations have published lists of alleged tax heavens, but, nevertheless, the composition of such lists is rarely unchanged and neutral. As most of structures of our society nowadays, they, too, are frequently influenced by political interests. Some of the most popular are British Virgin Islands, Hong Kong, Dubai, Seychelles, United Kingdom, in fact, and Mauritius. Besides the ethical considerations, this practice is negatively affecting the domestic economies, as it determines great capital outflows, which can distort the national GDP figures. While production may still be linked to the national economy, the value added is usually recorded in the jurisdiction where profits are reported rather than where the economic activity takes place. This misallocation complicates macroeconomic analysis and policymaking, as key indicators no longer accurately reflect real economic conditions. Another downside lies in the erosion of the domestic tax base, because when companies shift profits abroad, less corporate tax revenue is collected, which can constrain public spending and investment, ultimately affecting the infrastructure development, social and economic stability. (CORPNET, 2017)

On the other hand, when applied adequately, creative accounting can influence the recognition of current-period expenses and contribute to a more accurate representation of period earnings. While it is accountant's responsibility to faithfully record all inflows and outflows, excessively conservative practices, such as immediately expensing all investments, may distort financial performance and ultimately undermine the economic reality of the business. Costs that should be spread over time get pushed into the present, which drags down reported results, making it harder to see the company's actual value in the end, especially when those expenses are meant to generate future benefits. An extremely actual example would be the capitalization of AI implementation in accounting practices. If giant corporations decide to infiltrate AI softwares in their accounting to automatize the daily processes and enhance efficiency, they will opt for platforms that can provide maintenance of hundreds of clients' needs simultaneously, and such a scale and performance is extremely costly. For instance, the services Trullion provides are reported to start from thousands of dollars per year, and it can completely assist the customer in tracking their Corporate Accounting, Audit, and the Financial Transformation and Advisory. An inquiry from the "Generative AI in Professional Services Report", provided by Thomson Reuters Institute, shows that 59% of the respondents are not measuring the return-on-investments of GenAI tools at all, and only 20% do keep track of all the money invested in technological advancements. This highlights that many firms are yet to perceive the costs of AI-powered practices as actual investments rather than general expenses, and the lack of capitalisation of AI can drastically alter the profits of the current period. Instead, using the flexibility the creative accounting provides, it would be better to record them as intangible assets on the balance sheet, as it allows spread the costs over time, via amortization. If recorded as a strategic investment, not as an immediate expense, it can build investor confidence and credibility, this underlining the positive side of creative accounting exploitation.

Unfortunately, more often than not, creative accounting is used with a malicious intent, and scandals happen, they echo everywhere, convicting the flexibility provided by the existent frameworks. This happened during the WorldCom's downfall too, this being one of the most significant accounting frauds in US history, involving the misstatement of approximately \$11 billion in earnings. Once a leading telecommunications provider, its fallout resulted in over \$180 billion in

losses for investors. It used the aforementioned technique of capitalising on expenses to fraudulently inflate its income, which was reportedly exaggerated with 3.8 billion USD. Besides, in order to increase its market share, WorldCom pursued acquisitions aggressively by buying up rival companies, however this ricocheted off as a major drop in revenue and rates, further worsening the financial position of the firm. The fraud was discovered by several individuals which included Cynthia Cooper, who was vice president of WorldCom's internal audit department, and Gene Morse, another auditor. After personal investigations, the two contacted KPMG, as well as WorldCom's audit committee. And, indeed, the sure way to detect fraudulent activities is through auditors. (Investopedia, 2025)

The role of auditing becomes clearer in situations where managers have room to interpret accounting rules. That same discretion can be used to reflect the company's real position or to shape it in a more favorable way. In systems based on standards issued by the International Financial Reporting Standards Foundation and enforced by regulators such as the Securities and Exchange Commission, audits act as a control mechanism that keeps this flexibility in check. By offering an independent review of financial statements, auditors help make the reported information more reliable and reduce the gap between what companies present and what stakeholders believe.

But beyond relying on auditors, accountants themselves should acknowledge the IFSR, the should track the updates and ensure full compliance not only to the legal frameworks, but also to the ethical standards of a society, entity and the personal moral values. If IFRS highlights that 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, than such valuations must remain anchored in economic substance and not be overstated, as artificially inflating asset values will eventually undermine the reliability and credibility of financial reporting. The Association of Certified Fraud Examiners has conducted a study in 2024 regarding the total amount of fraudulent cases revealed in the accounting field in 2022-2023 across 138 countries, and 1,921 cases of law violation were found. Financial statement fraud is the most damaging target of malicious creative accounting implementation, as the average loss per case was registered to reach 776,000 USD.

Although the loopholes can be stretched, once the reputation is being questioned, the company suffers a bigger loss than money. While the impact of the monetary losses is immediate, the long term harm causes more fright. Losing the customers' and investors' trust means the falldown of a business, for fundraising alimentates companies and shapes their growth, development, and future international expansion. However, once credibility is compromised, access to capital becomes significantly constrained. Investors are far less willing to allocate resources to firms perceived as unreliable, which not only limits expansion opportunities but may also threaten the company's very survival.

CONCLUSION

Concluding, creative accounting is a complex and multifaceted phenomenon, the central issue being not the existence of flexibility itself, but the ethical boundaries within which it is applied. As demonstrated throughout the analysis, the same techniques can either enhance the accuracy of financial representation or distort it, depending on the intent behind their application. Consequently, safeguarding the credibility of financial reporting requires not only robust regulations and effective auditing, but also a sustained commitment to ethical responsibility at both the individual and organizational level.

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