Chapter 13

Creative Accounting and Its Impact on Financial Statements

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ABSTRACT

Creative accounting responds to the same issue faced by the management, but the answer lies at the boundary between the legal and de facto recording of the economic event, leaving accountants to create the entity’s economic reality. The manager of the entity can choose from the multitude of accounting treatments and policies, the one that is most convenient and responds best to their own interests, which implies that the outcome may be convenient and not necessarily true. This chapter presents the implications and challenges of creative accounting on financial statements. The results show that the main controversy raised by the standards refers to the need for periodic reassessments and the possibility of choosing a method of measuring the value, which creates premises for the practice of creative accounting.

INTRODUCTION

Creative accounting, operating at shade - area - where accusations substantiated by non-compliance with professional or legal norms can be brought, but where common sense logic notifies the presence of a certain dose of “forcing the note” (Dennis, 2014; Richardson, 2011; Englund & Gerdin, 2018).

Using creative accounting for intangible assets, especially in her gray area favored by accounting rules, makes it difficult or even impossible to guess the true value of these assets (Florou & Pope, 2012). This manipulation of accounting information can be done within the law and accounting rules or outside them (Florou & Pope, 2012). In the latter case we are witnessing an illegal practice: accounting fraud. Although there is a clear difference between creative accounting and deliberate violation of the law (fraud), “there is always a clear demarcation between the situation of creative accounting practices and accounting malpractice” (Damayant, 2013).

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Accounting engineering’s are defined by some authors as representing “the process whereby, given the existence of gaps in the rules to manipulate accounting numbers and taking advantage of flexibility, those practices are chosen for measurement and information that allow transforming synthesis documents from what they should be in what managers want” or “the process by which transactions are structured in such a way as to allow to produce the desired accounting result (Barth, 2013).

One criticism of the procedures above concerns that they contain a certain “dose” of creative accounting with the character of subjectivity with the realization that they change the presentation of accounts, but are nonetheless the result of an option, when selected from among more methods, which makes us say that they are within the accounting regulations (Baker & Bettner, 1997; Ahmed, Neel & Wang, 2013).

This chapter presents the implications and challenges of creative accounting on performance. The results show that the main controversy raised by the standards refers to the need for periodic reassessments and the possibility of choosing a method of measuring the value, which creates premises for the practice of creative accounting.

BACKGROUND

It is obvious that theorists have had different approaches to the concept of creative accounting. If for some authors the attribute of creativity in accounting is represented by a set of procedures that take into account the change of the level of the result in order to increase or decrease it, or the presentation of the financial statements without these objectives being excluded from each other, for others it represents the aggregation of accounting techniques and operations which, without departing from the accounting rule, allow the managers of an enterprise to change the resulting amount or change the appearance of the accounting documents (Ahrens, 2008; Bettner & Kate, 2013; Lukka, 2010; Ramanna, 2008).

The year 2006 brings new approaches to creative accounting (Brown, 2010). Thus, Holthausen and Watts (2001) argue that the real incentive for creative accounting is represented by the conflicts of interest between different groups: the case of investors and shareholders wishing to obtain more capital gains and dividends, while employees intend to get higher wages and share profit, or target shareholders who are interested in paying lower dividend taxes, while the country’s tax authorities would like to collect more taxes.

Following this negative strand, for some time creative accounting has been isolated from other sciences and practices. The one who noticed it from a positive perspective was Doukakis in 2014, who feels that there may be flexibility in accounting, which at the same time provides a true and fair view of the accounts so that they can serve its interests while also taking the form of fraudulent financial reports when used for managing, measuring, and presenting accounts so as to serve the interests of financial statements and fraud, or to give a false picture to the accounts.

The most important definition of creative accounting belongs to Parker (2012), who argues that creative accounting is: (1) the process which allows the transformation of documents by the accounting figures that are being manipulated, given the existence of breaches in the rules, and, taking advantage of the flexibility, synthesizing practices from what they should be into what the managers want them to be; (2) the process where transactions are structured in such a way as to produce the desired accounting result.

We believe that the main reason for the emergence of creative accounting practices is the differences in the information needs of the accounting information users (investors, employees, suppliers, customers, creditors, state and public institutions) and the purposes they have in using this information. In view of
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