ACCOUNTING PRACTICES FOR ADJUSTING THE ENTITY’S RESULTS

PRACTICI CONTABILE DE AJUSTARE A REZULTATELOR ENTITĂȚII

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An enterprise’s financial result is the main source of information for all those interested in the company’s activity. As a result of being normalized and audited, the information offered by accounting receives the “social recognition”, recognition which allows them to be used to evaluate the enterprise’s activities and performances. Although there are accounting laws, the options and/or the imprecision in the accounting texts allow for the possibility to manipulate the financial result and the content of the financial statements. Within the liberty offered by the different source of accounting law, the enterprises can choose between the options which are at the base of presenting the financial statements. The choices made by the enterprise’s management with the purpose of modeling in a legal way, the presentation and the content of the financial statements are known as accounting policy. Within an enterprise, developing the accounting policies represent a primary aspect, because applying these policies determine a high degree of financial information relevance and lead to better management choices.

Key words: accounting practice, accounting policy, results, adjusting.

The company’s accounting policy and the results’ management

The Oxford Accounting Dictionary defines the accounting policies as “the specific accounting basis used permanently by an organization when writing the financial statements; these basis are considered and determined by the organization as the most adequate for accurately presenting its financial results and operations”. The Romanian accounting legislation uses the same concept of accounting policies as the international framework, these representing: “the specific principles, basis, conventions, rules and practices approved by an enterprise when writing and presenting the financial statements”. In another vision, the accounting policies are the options determined by certain interests, while taking into account the principles, rules and conventions regarding accounting, recognizing and valuing the elements described by accounting models when writing and presenting the financial statements.

A more detailed definition is given by Christopher Nobels: “The accounting policies are detailed valuing, measuring and recognizing methods
which an enterprise has chosen among those accepted by law, accounting standards or commercial practices”. These policies must be used on a permanent basis and must be publicized.

When a certain accounting policy is chosen, the enterprise’s management should use it during the following years as well. For example, publicizing the policies would state what impairment method was used, if valuing the stocks was done by using FIFO or other method, how the interests for financing an impaired asset were accounted for and so on. The adopted and used accounting policies represent a decisive element in regard to writing and presenting the financial statements which will be useful to users when taking decision. The accounting policy, chosen by managers, represent most of times, the object of a real strategic management which have an important effect upon the measurement of accounting results. If within the field of applying the accounting policies we find the choices made upon the content of the published financial statements, the accounting policy is, as Casta stated, stated within “a double logic of optimization of choices and of financial communication between the enterprises and their environment”. The accounting policy is reflected by the options used by the enterprise’s management in order to manipulate the result and the content of the financial statements. An enterprise that promotes a profit maximization strategy despite the “fiscal prejudice” of giving the dividends and attracting the investors, tries to find all the possible solutions in order to attain that desideratum. Therefore, in the Anglo-Saxon accounting environment, in order to attract investors, the enterprises are tempted to promote estimates and methods which lead to a profit maximization strategy. If we use as example the impairment method used by British enterprises, these will promote the idea of deducting the residual value from the buying cost in order to reduce the impairment costs and increase the profit.

In the countries where the German accounting model is used, the companies are trying to promote a profit minimization strategy. Therefore the methods and estimations used will result in a minimization of the profit. Hence, the provisions are estimated at a very high value compared to the real risks and impairment covered, while the amortization period are most often the maximum time allowed by the fiscal authority. In the Romanian accounting environment, because of high pressure from the fiscal authority, many enterprises tend to promote a profit minimization policy, with consequences upon the income tax. As an example, the enterprises that promote a profit maximization policy are tempted to capitalize certain costs in order to impair them. On the other hand, the enterprises that promote a profit minimization strategy are tempted to account as costs certain values that should/could be capitalized.

The accounting result has informative value only for the managers and the employees who worked at the accounting informing system, these being the ones who know the enterprise’s policy. In a situation of asymmetric information we find the shareholders and the external analysts who are excluded from defining the accounting policies. Therefore, it’s necessary to redefine the role of the accounting
result in the relationship between managers and shareholders. Hence, because the result is fixed between certain limits, it is regarded, mostly as a “signal which allows shareholders to approve their own predictions regarding the future financial flows generated by the enterprise, rather than objective criteria which will allow the real measurement of the company’s performance”.

**Adjusting the Results under the Influence of Bad Accounting**

The result of researches done along the years regarding creative accounting proved that the financial result can be modeled as a result of the choices made by an enterprise. The accounting policy which the enterprise’s management chooses most of times represents the object of a strategic management with effect on calculating the accounting result. The presence of choices in accounting, both for individual and corporate accounts, allow for the result and the financial statements to be modeled. Using the freedom given by the accounting options, the enterprise’s management will be tempted, according to what it wants to obtain, to “alter” the result, or to offer a better view of the financial situation of the enterprise. The subjectivism is present in calculating the result, the “game” of choices offering favorable ground for the use of creative accounting.

The international standards - IAS and IFRS - allow in certain situations for the same transactions and events to be accounted in two different ways. In the standards it’s referred as benchmark treatment and allowed alternative treatment. If the enterprise chooses a certain treatment, the information given to the users will different from the one given if the other treatment had been chosen. In order to manipulate the results and achieve their “desires”, the enterprise’s management can use either one of the treatments (they can set the level of the result based on what they want to achieve).

There are instances in which, in order to achieve certain objectives, the enterprise’s management uses “accounting engineering”, an assembly of actions, techniques and practices which change the result in order to maximize or minimize it. The actions used are based on the choices allowed by the accounting regulations, possibilities open by the weaknesses in the accounting norms, as well as by the mechanisms in which accountancy can change the results legally. No matter what the purpose is, manipulating the result has negative influence upon the quality of the information offered by accountancy. Within these actions of modeling the result, an enterprise might use: “subjective impairment” of assets, the impairment expenses, provisions, the options between the two methods of accounting for the construction contracts, adjusting the expenses and income, financial facilities, stocks, development expenses, so on.

a) Subjective Depreciation of Assets

The practice of “subjective impairment” of assets creates a field opened for creative accounting. On the basis of professional reasoning, IAS 36 “Impairment of Assets” asks that at each balance sheet date, the enterprise has to review all assets to look for any indication that an asset may be impaired. If the enterprise’s
management decides that the recoverable amount is lower than the accounting net value, the asset will be impaired for the difference. In this situation, the result will be affected by accounting for an impairment expense. On the other hand, if the enterprise’s management follows an “optimistic” attitude of the result, it will decide that there are no clues that the asset has suffered any depreciation, hence avoiding accounting for the impairment expense and diminishing the result.

b) The Impairment Expenses

Different impairment methods lead to different impact upon the result. Based on the method used, the impairment expenses are accounted for differently during the years: the linear method leads to constant impairment expenses over the asset’s economic useful life; SOFTY leads to higher impairment expenses during the first years, allowing for more investment funds, higher in the period when the tax on profit is lower and therefore the profit is lower; the progressive method (opposite of SOFTY) leads to higher profits at the beginning of the asset’s economic useful life and lower profits at the end; the regressive method means lower impairment expenses as the years go by.

Different options regarding the asset’s economic useful life lead to different impairment expenses, therefore different effects upon the result. Re-estimating the economic useful life leads to adjusting the impairment expenses for the current and future years. Deducting the residual value has as effect lower impairment expenses and therefore higher results.

c) Provisions

The provisions’ policy (increasing or decreasing them) is a very useful tool for “tempering with the result”. Ignoring the risk provisions leads to a changed view upon the enterprise’s results. Accounting for 100% provision means the enterprise has a pessimistic view. Both policies lead to negative effects upon the quality of the information presented by the accountancy.

The enterprise’s management will be tempted to use higher provisions if the company is prosperous in order to avoid paid high income tax. Hence, parts of the provisions are actually masked resources. On the other hand, the management of a less profitable enterprise will be tempted not to use provisions or to use very low provisions in order not to lower the income or to limit the loss.

d) Using one of the constructions contract options

Choosing between the two options for the constructions contracts has an impact upon the enterprise’s results: accounting for the contract when it’s finished means that the result will be calculated at that time; accounting for the contract as it develops means that the result will be calculated during the time the contract is active.

Switching from one method to another has a very strong impact upon the profit and loss account.

e) Adjusting the expenses and income

Usually, at the end of the fiscal year, in order to obtain a certain image of the enterprise’s result, the management uses a series of methods to adjust the
expenses and income, as follows: accounting for the invoices for services that will be executed in the next year or not accounting for services for current year for which the invoices haven’t arrived yet; not accounting for expenses or income from rents; issuing invoices for services or goods which will be sent/done during the next year or sending the goods in the current year and issuing the income during the next; accounting too late for the interests paid or to be given from the financial activity or from buying/selling over multiple years.

f) Fiscal Facilities

Not only does the fiscal legislation offer the legal ways to “temper” with the results, but it also offers certain facilities for the enterprises. These facilities are conditions by fiscal accounting registrations.

g) Stocks

The stocks offer enough opportunities to “model” the result. Including the dead stocks in the stocks or including the used ones represent a very good way to adjust the result. If the dead or used stocks will be taken out of the inventory, the expenses will be affected, therefore having consequences upon the result, diminishing it. On the other hand, the enterprise’s management can have an optimistic attitude considering that the dead stocks will be used, especially during recession. An error recognized intentionally when determining the stock in the inventory at the end of the fiscal year can lead to “tempering” the result, either by over-valuing or under-valuing the final stock which can impact not only the financial statements for the current year but those for the next year as well. Adding or not the expense in the acquisition expenses can create opportunities for modeling the result. When the enterprise’s management has an optimistic view, it will add to the production cost more expense, while when wanting to diminish the result in order to pay a lower income tax, it will eliminate some of the expenses from the production cost. Different stock valuing methods when the stocks leave the inventory lead to different images upon the result. During inflation, using FIFO and LIFO has the following impact: when using FIFO, valuing the stocks sold is done at the lowest prices, while the final stocks are valued at the highest prices, leading to a higher income and therefore higher income tax; when using LIFO, valuing the stocks sold is done at the higher prices, while the final stocks are valued at the lowest prices, leading to lower income and therefore lower income tax. During deflation the situation is reversed. The result is changed based on the valuing method used when the stocks leave the enterprise.

Including the financial expenses in the production cost has as effect an increase in the result for the year when the expenses were accounted for. On the other hand, if the management has a pessimistic view upon the result, it will use the result method, accounting for interests as expenses during the year.
Instead of closing

The enterprise’s management is tempted in certain situations, to use the “pervert” part of creative accounting with the only purpose of giving the users the image they want, most of times better than the real one.

It’s necessary to use the ethics when producing, auditing and giving the accounting information, as long as the enterprise wants to give an objective and creative image of the financial position and performances of the enterprise. Although the data in the accountancy can be made perfect, we should not forget that the enterprise’s image depends on the ethical behavior of the accountant and auditor, but also on how well the message is sent by the information users.

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