THE ROLE OF PROFESSIONAL ACCOUNTING REASONING IN ENSURING STANDARDS OF PREPARATION AND CERTIFICATION OF FINANCIAL STATEMENTS

Mihaela-Raluca Boharu (Mircea)[1*], Cristina-Elena Florea (Poenaru)[2]
[1) 2)] Valahia University of Targoviste, Targoviste, Romania.

Abstract
The whole of humanity is nowadays going through an extremely difficult period, as the medical-financial crisis is affecting the entire economic sector. Given this crisis, in order to improve or combat difficult situations, special emphasis is placed on obtaining accurate and objective financial information. The focus is now on the professional accountant whose reported data become decision-making factors for external users. Among these external users, we mention: investors, shareholders, banks, authorities and last but not least the population at large. Given these aspects, we propose to investigate in this article the way in which the professional accountant is forced at certain times to resort to subjectivism. If so, in what situations and determined by what factors and by what means these situations can be controlled. On the other hand, we will investigate how the balance between objectivity and subjectivity cand be respected in the application of the professional reasoning of the accountant and how the fidelity and the accuracy of financial accounting reports can be ensured. The research methods include qualitative methods as studying the scientific literature and practical documentation in economic units but also the quantitative-descriptive methods by developing case studies. The result of this article estimates as accurate as possible of the extent to which the manifestation of the creative accounting can influence the accuracy of the information regarding the real situation of the economic activity.

Keywords
professional reasoning, financial statement certification, streamlined financial management, reporting standards.

JEL Classification
M40, M41, M42.

---

[*] Corresponding author, **Mihaela-Raluca Boharu (Mircea)** – ralcont2003@gmail.com

Introduction

We consider that the study carried out is a topical one in the conditions in which in a difficult economic period, when the economic activity starts to be affected, the temptation to be subjective or creative is inevitable.
In times of crisis and in difficult economic situations such as the present, humanity focuses its attention on those who obtain and use financial information to overcome these difficulties.
The data reported by the professional accountant become decision-making factors for external users who take this information pertaining to the real situation in order to guide their activity and to make decisions regarding business continuity. The professional accountant must provide all this information extremely faithfully and accurately, having the main goal to not mislead significant categories of users: shareholders, investors, banks, authorities and, last but not least, the population at large.
All entities must periodically prepare and publish information about the financial situation.
Regarding the study, we aimed to answer to the follow questions:

- Are there situations in which the professional accountant has to resort to subjectivity?
- What are the means by which these situations can be controlled?
- How can the balance between subjectivity and objectivity be observed while enforcing professional reasoning?
- How can the fidelity and accuracy of financial-accounting reports be ensured?

In order to provide possible answers to these questions, we will proceed to investigate these issues. The working procedures of the research are based on approaching the problem both theoretically and practically, by studying the literature, analyzing the legislation, the international standards in the field and the performing practical documentation within economic units, as well as developing a case study.
Starting from what objectivity entails, the professional accountant must avoid situations of incompatibility or other situations, such as conflicts of interest, since all these external users may question its objectivity (Mulford et al., 2002).
They must not jeopardize the integrity of the services provided. In compliance with the ethical requirements related to objectivity, certain aspects must be taken into account, such as: the development of special situations when, under pressure, professional accountants may put forward a subjective interpretation of those particular situations.

1. Review of the scientific literature

Creative accounting practices are not a new idea. Ever since the 2000's this phenomenon has been publicized due to global financial scandals, such as Parmalat, Enron etc.
If we searched in international databases using the keywords "creative accounting", limiting ourselves to articles containing this concept in their title or abstract, or

addressing topics closely related to the phenomenon of creative accounting, we would be able to identify an impressive number of articles.
The largest number of articles was published in 2006 and the researchers' interest in this related topic of creative accounting increased after the year 2000.
Most articles appeared in the Critical Perspectives on Accounting (CPA) (more than 15 articles), Abacus – A Journal of Accounting Finance and Business Studies (ABA) and in the European Accounting Review (EAR).
Creative accounting is the result of the complexity of the economic reality alongside psychological factors particular to human beings. Creative accounting can be defined as a set of procedures that aim either to change the level of the result, in order to maximize or minimize it, or to present financial statements.
Accounting options have always been available to the accountant and do not involve creativity in the strictly negative sense of the word.
According to Sen and Inanga, "the use of creative accounting has increased in many developed countries in recent years" (Sen et al., 2009).
Feleagă (1999) defined the creativity of the professional accountant as aiming at "founding the financial structure and performance of the company, professional accountants through an excess of ingenuity, managing to make enviable arrangements to maximize earning per share, to improve liquidity or to minimize the rate of financial indebtedness" (Feleagă, 1999).
Most researchers, however, agree that, in essence, creative accounting is distinguished by
two aspects:

- it entails using the imagination of professional accountants to translate those legal, economic and financial innovations for which there are no standardized accounting solutions at the time of their occurrence;
- the implementation of specific techniques in creative accounting is done according to their impact on the financial position and the economic and financial performance of the entities involved (Malciu, 1999).

Kamal Nasser defined the concept of creative accounting as follow: "the process by which, due the gaps in rules, accounting information is manipulated and taking advantage of flexibility; those measurement and information methods are chosen that allow the transformation of summary documents from they should be to what managers want; at the same time, it represent the process by which transactions are structured in such a way as to allow the desired accounting result to be obtain" (Naser , 1993).
In the same way, Jones defined creative accounting as "using the flexibility within the regulatory framework to manage the measurement and presentation of the accounts so that they give primacy to the interests of the preparers not the users. Creative accounting is thus seen as working within the regulatory system. Is this thus not illegal. Companies using creative accounting are not breaking the law, just using the flexibility in accounting to serve their own interests" (Jones M. J., 2010).
According to Vladu, A.B., Amat, O. and Cuzdriorean ''accountants preparing information are in a position to manipulate the view of economic reality presented in such information to interested parties. These manipulations can be regarded as morally reprehensible because they are not fair to users, they involve in an unjust exercise of

power, and they tend to weaken the authority of accounting regulators" (Vladu et al., 2016).

Achim and Borlea, highlighted the comparison of the American journalist Ian Griffiths. He associates creative accounting with the Trojan Horse ''in the sense that he approached of this method is a great deception for those to whom the synthesis documents are presented". Paraphrasing the journalist, he claimed that the people who practice the accountant profession have different ideas, different personalities, different techniques.

At the same time ''the states that applying creative accounting techniques respect the spirit of the law, but no its letter" (Achim and Borlea, 2019).

''Creative accounting is legal, it may even be a factor of reaching a faithful image, when applied in good faith (Groșanu, 2013). Creative accounting may prove to be closer to fraud, "if the gateways from regulations are used to obtain advantages by certain categories of users of the accounting information to the detriment of others." (Groșanu, 2013).

Here, are identified two aspects regarding creative accounting one with a negative character and other by which creative accounting it may contribute to achieving the faithful image.

„Manipulation of accounting information to transform the financial statements of companies, which should show a true and fair view of accounting, but their creators try to transform them into a form according to their dispositions and further to those that implement deeper interventions in the accounting of specific companies based on subjective interest and objectives" (Parker et al., 2018).

The main essence of financial statements is a true and fair view of accounting because accounting information is an essential source of information about the company, which in the global business environment is used by other internal as well as external entities (Svabova et al., 2020).

Herve Stolowy's opinion is different. He doubts the existence of creative accounting considering that "it is a pure illusion" (Stolowy, 2000).

The dominant trait of the professional accountant must be reason, as we cannot precisely define all these special situations, and it is vital that they avoid all aspects that could be seen as having a negative or harmful influence on their professional judgment.

Continuing with the scientific literature we chose the Financial Reporting Standards as a starting point, standards also known as IFRS (International Financial Reporting Standards). They are a set of accounting standards and are currently issued by the International Accounting Standards Board (IASB).

Based on the fact that ethics pushes the professional accountant to display objectivity and honesty when performing his missions, and given that all entities must enjoy a high value based on high moral principles, corroborating all this we bring to the fore the National Code of Ethics for Professional Accountants [IESBA, 2018].

The National Code of Professional Accountants, in the section 120, referring to OBJECTIVITY and to the principle of objectivity, specifies: "the principle of objectivity requires all professional accountants to be impartial without preconceived notions, not to find themselves in situations of conflict of interests or incompatibility and not to compromise their business judgment through the influence of sympathies, of a conflict of interests or of the exaggerated bearing of another person".

Internationally, the International Federation of Accountants (IFAC) has as its main mission "strengthening the global accounting profession to harmonized standards, capable of providing high quality services in the public interest."

Thus, in order to fulfil this mission, IFAC has established the International Ethics Standards Board for Accountants. The role of this board is to issue high quality ethical standards and other services to professional accountants around the world. All of them came into existence on June 30, 2006.

All the requirements stipulated in the Code of Ethics promote the observance of four objectives [CECCAR, 2019]:

- CREDIBILITY - external users need credible information;
- PROFESSIONALISM - external users need people identified as professionals in the financial accounting field;
- QUALITY OF SERVICES - the services provided by a professional accountant must be performed at a high level of quality;
- TRUST - external users count on the fact that this Code of Ethics gives them a certainty regarding the ethical conduct underlying the activity of the professional accountant.

2. Research methodology

The research methodology used in the elaboration of the study is based on qualitative methods but also quantitative methods. The qualitative methods include the review of the scientific literature and practical documentation in economic units and the quantitative-descriptive methods refer to the presentation of some significant case studies.

The working procedures of the research are based on approaching the problem both theoretically and practically, by studying the literature, analysing the legislation, the international standards in the field, as well as by performing practical documentation and the elaboration of a case study.

Starting from the definition of accounting as "a main instrument of knowledge, management and control of assets and of the obtained results", knowledge can often be subjective, each professional accountant having a certain level of training.

The concern for an objective approach to asset management and control differs greatly from one entity to another.

3. Case studies

"*The supporting documents underlying the accounting entries entail the responsibility of those who prepared, signed and approved or registered them in the accounting system, as the case may be*" [Accounting Law no. 82, 1991].

This is an excerpt from the Accounting Law. From it we gather that the basis of all accounting records is the objectivity of the professional accountant.

Double accounting records entry is based on the objective knowledge of the accounting transactions. We recall:

- the objective registration of the corresponding accounts, the objective observance of the rules of accounts operation;
- the objective calculation of the corresponding amounts;
- the reality of the operations and their correct classification in time.

<u>*Case study no. 1*</u>

What follows is an approach to how we can treat the accounting operation objectively/subjectively. As a first example, we have an asset valuation operation. The objective treatment of the operation encompassed the observance of the accounting principle called "The principle of the independent exercise". What does this principle entail? "*Revenue and expenditure relating to the financial year must be recorded in the course of that particular financial year, irrespective of the date of receipt of the revenue or the date of payment of the expenditure*" [Profesional Standard 37, 2011].

External users of financial statements can obtain data about a company's financial situation through these statements. Thus, when an asset is registered, for example, it is mandatory to comply with the method of valuing this asset, according to all legal rules in force, so that at the end of the economic and financial year, these financial statements objectively reflect the activity of the company. The figure below shows the types of values according to the ANEVAR Guide (Figure 1).

Content
Introduction
Types of value
Types of value defined in IVS- Market value
Types of value defined in IVS- Market rent
Types of value defined in IVS- Fair value
Types of value defined in IVS -Investment/ subjective value
Types of value defined in IVS -Synergy value
Types of value defined in IVS -Liquidation value
Other types of value- Fair market value
(Organization for economic cooperation and development (OCDE))
Other types of value- Fair market value (United States Tax Service)
Other types of value – Fair value in different jurisdictions
Premises of value /Existing use
Premise of value- Current use/Existing use
Premises of value – Orderly sale
Premises of value - Forced sale
Entity specific factors
Sinergy
Special hypotheses/ hypotheses
Transaction costs

Figure no. 1. Types of Values

Source: Valuation Standards – SEV 104 <u>*www.anevar.ro*</u>

Objectively, the professional accountant can use as valuation methods: valuation at purchase price, at market value and at production cost (Deaconu , 2009).

The subjective approach to the operation involves the recording of values different from those provided by the evaluation report performed by an ANEVAR (National Association of Authorized Assessors in Romania) authorized evaluator.
The ANEVAR Evaluation Methodological Guide (EMG) specifies: "*the type of estimated value according to the definitions in the evaluation standards applicable in Romania are the market value, the special value, the investment value etc*." [EMG 600, Enterprise Evaluation].
We recall these mandatory requirements because the practice of overvaluing financial securities, real estate, gives banks where the former is offered as collateral, a false image of the business. Audit reports, where available, may provide limited information to them only if there are paragraphs of the auditor or where the auditor has expressed an audit opinion [THE WORLD BANK (IBRD), 2013].
Article 24 of the same Guide specifies that "*adjustments to the financial statements shall be made where necessary, on the reported financial data, for relevant and significant items in the valuation process.*"

Case Study no. 2

We present another case study, in which the professional accountant, using creativity in terms of complying with the accounting standards, puts himself in a position of subjectivity regarding the observance of accounting principles and rules, ensuring the accuracy of integration of accounting information in annual/half-yearly financial statements (Figure 2).

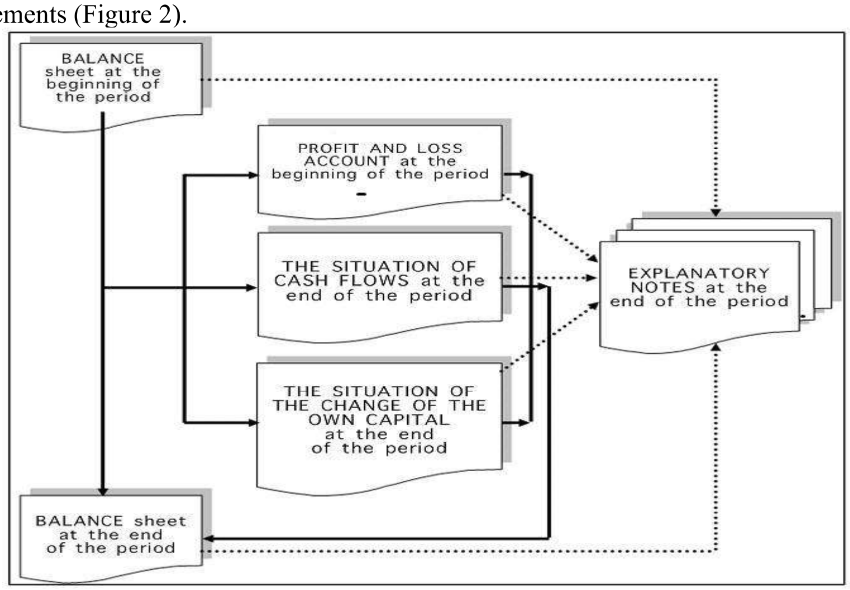

Figure no. 2. The links between the documents that make up the financial statements

Source: Duţescu A., A Guide to Understanding and Applying International Accounting Standards 2nd edition, revised, CECCAR Publishing house, Bucharest, 2002, p. 65

The present study was carried out in an ALFA company in which the situation is as follows:
The company owns a machine worth 241,000 Lei which, during the COVID 19 crisis, when the company's activity was suspended, was not out of use.
Following the analysis of the results presented below in the Table 1 and given the context in which the company benefits from a credit line to ensure its immediate liquidity, the chartered accountant comes up with the solution of recalculating depreciation, correlated to the period used, so that by decreasing expenses the company would record the minimum profit which would ensure the continuity of financing, maintaining the credit line and continuing the economic activity in extreme situations.
The table 1 below presents the results in the profit and loss accounts of the company as follow:

Table no. 1. Excerpt from the Profit and Loss Account at ALFA Company

Expenses	**1000s RON**	**Income**	**1000s RON**
Operating expenses (expenses on stocks, expenses on works and services performed by third parties, expenses on staff, taxes and fees etc.) Operating result (loss)	1.761 22	Operating income (income from the sale of goods and the provision of services, from the production obtained, from operating subsidies etc.) Operating result (profit)	1.739
Financial expenses (expenses on assigned financial investments, interest rates, expenses on exchange rate differences etc.) Financial result (loss)	30 19	Financial income (income from financial fixed assets, from short-term financial investments, from interest rates, exchange rate differences etc.) Financial result (profit)	11
Expenses on income tax (profit)	16		
Net result (loss)	**57**	**Net result (profit)**	**-**

Source: Personal source.

According to item 139 (4) of OMFP no. 1802/2014, when the elements that were the basis for the initial establishment of the economic use period have changed, the entity establishes a new decrement period, in compliance with the provisions contained in these regulations.
A change in the life of an asset is a change in an accounting estimate. The effect of the change in the accounting estimate must be accounted for both during the change period, that is in the current period, and in subsequent periods [OMFP 1802, 2014].
Following the restatement of the depreciation expense, the statement of the profit and loss account may be different, as follows in the Table 2.

From the point of view of the professional accountant, the prolongation of the asset's life has the effect of decreasing the depreciation expense at the same time as the profit increases, given that the associates aimed to increase the latter, the company being on the verge of a negative financial result which would have led to the loss of the credit line that ensures the immediate liquidity of the company.

Table no. 2. The Statement of the Profit and Loss Account Post-Restatement

Expenses	1000s RON	Income	1000s RON
Operating expenses (expenses on stocks, expenses on works and services performed by third parties, expenses on staff, taxes and fees etc.) Operating result (loss)	1.701	Operating income (income from the sale of goods and the provision of services, from the production obtained, from operating subsidies etc.) Operating result (profit)	1.739 38
Financial expenses (expenses on assigned financial investments, interest rates, expenses on exchange rate differences etc.) Financial result (loss)	30 19	Financial income (income from financial fixed assets, from short-term financial investments, from interest rates, exchange rate differences etc.) Financial result (profit)	11
Expenses on income tax (profit)	16		
Net result (loss)	**-**	**Net result (profit)**	**3**

Source: Personal source.

The conclusion drawn from the above study is that the chartered accountant may be arguably subjective, which we can also call creative, taking care not to prepare reports that provide erroneous information to users. Professional accountants do not risk fraud or error, as all this creativity must be followed by a transparent objectivity in the preparation and certification of financial statements.

In other words, regarding objectivity and subjectivity, we hold that the professional accountant must have both practical and theoretical knowledge regarding accounting objectivity and subjectivity [Dascălu R., 2020].

They must know accounting policies and use creativity subjectivity to ensure the credibility of financial statements. The rationale is that all decisions must be based on the usefulness of the information provided and the use of value judgments based on the latest credible and relevant information that the entity has at any given time [Professional Standard 21, 2011].

The principle of permanence of the methods requires that the accounting policies that have been established must be maintained during a financial year, but also from one financial year to another. Changing accounting policy leads to different results. Changes

in accounting policies are permitted only if requested by a competent authority (regulatory change) or if they result in more credible and relevant information about the entity's financial position and performance. The effects of changes in accounting policies for the current financial year are accounted for in the income and expense statements for that particular period, and those for previous financial years are registered in profit or loss, only if the effects of the change are quantifiable.
Issues related to the effects of changes in accounting policies and changes in estimates in the financial statements fall within the scope of IAS 8 (International Accounting Standards), Accounting Policies, Changes in Accounting Estimates and Errors.
The legislative regulations applicable in Romania are included in the Order of the Minister of Public Finance no. 1802/2014 for the approval of the Accounting Regulations regarding the individual annual financial statements and the consolidated annual financial statements, with subsequent amendments and completions within section 2.5 “Accounting policies, correction of accounting errors, estimates and events after the balance sheet date” [Duțescu A., 2002].
We live in a time where information as an economic resource is urgently needed in a constantly changing society. Financial-accounting information is the most important resource in the running activity of an enterprise. These resources are practically taken from this activity and conveyed to those categories of external users.
Below we have a chart that shows the relevance of this information, but also those attributes which set them aside from traditional, current information (Figure 3).

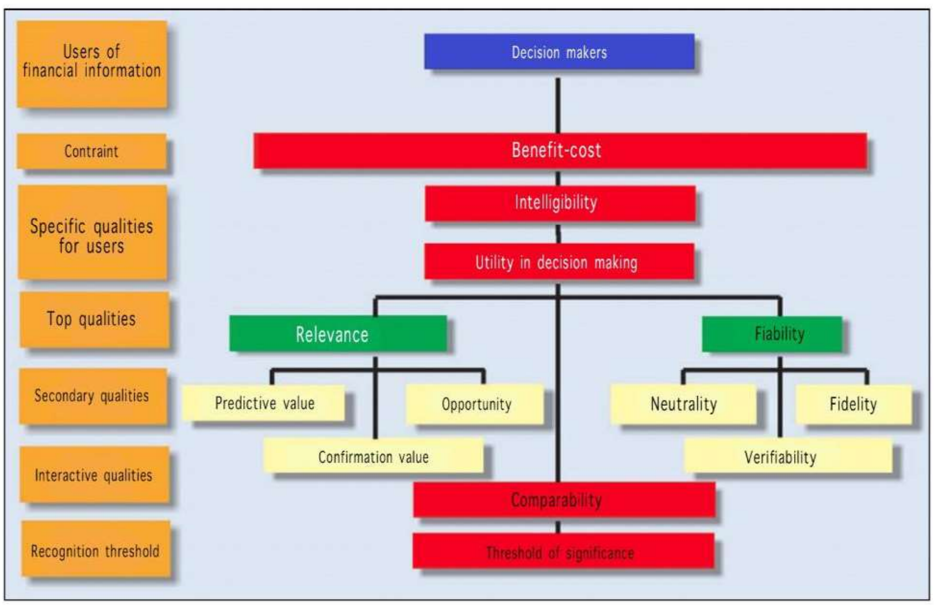

Figure no. 3. Characteristics of financial-accounting information
Source: N. Todea & I. Călean, The Relevance of Financial-Accounting Information in Crisis Situations, p.25

4. Results and discussion

The alteration of the accounting methods (policies) and the revision of the initial estimates of the economic entities in accordance with the new available information aim at improving the image of the financial position and performance or of their cash flows [Nicolaescu C. et al., 2015].

Accounting policies and valuation methods must not be changed during a financial year. They can be altered at the initiative of the entity's management, in which case the change in the notes to the annual financial statements must be justified, the reason being to obtain reliable and more relevant information about the effects of the entity's transactions or an exceptional change in the economic-financial context in which that particular entity operates.

Therefore, the outcome of an entity depends not only on its economic and financial performance, but also on the accounting policies chosen. Predicting the financial sustainability of a company in the short or long term is not an easy task. In conclusion, it is necessary to consider various variables, including the sector and the dynamics of the market in which the company operates.

The professional accountant considering the inherent uncertainties that arise in the activity of an entity and the fact that there are a number of elements in the financial statements for which it is not possible to make estimates with maximum accuracy, must estimate according to its value judgments based on the latest credible information available to him. Accounting estimates consist of assessments and valuations under conditions of uncertainty regarding the size of items, transactions and events.

Estimates of the following may be presented:

- provisions;
- the useful economic life of tangible assets, as well as the expected way of consuming the future economic benefits incorporated in the depreciable assets;
- the residual value of tangible assets;
- uncertain customers;
- the moral depreciation of stocks;
- the fair value of financial assets;
- the fair value of financial debts;
- warranty obligations.

Estimates may be revised in the event of circumstances that alter the facts. The change in an accounting estimate “shall be recognized prospectively by its inclusion in the result of:

- the period in which the change takes place, if it only affects that period (for example, the adjustment done due to uncertain customers); or
- the period in which the change takes place and future periods, if the change also affects them (for example, the useful life of fixed assets)”.

Conclusions

To conclude, the objectivity of the professional accountant by his providing of financial-accounting information, which presents the reality of an economic activity, leads to the elaboration of correct decisions. It should be borne in mind that the information provided adds value to the enterprise, and it is precisely on the accountant that depends the manner in which that added value will be measured.
Both in the case studies presented, as well as in other financial-accounting operations, they must be aware of the accounting policies involved and use that subjective thinking in a creative way.
If we refer to the cases previously detailed, the fair value measurement of that asset would within the asset valuation study, provide reliable, up-to-date, useful information compared to a historical cost measurement, a less relevant valuation that could create a distorted image for users, especially investors. Let's not forget that we are living difficult economic times.
The solution is to implement unified International Standards, which would improve the interpretation of documents and ensure a balance between those who provide information and those who receive it.

References

[1] Achim, M.V, Borlea S.N., (2019), *Economic and Financial Crime. Corruption, the underground economy and money laundering. Causes, effects, solutions. Theoretical and practical approaches, Romania,* Economic Publishing House , Bucharest
[2] CECCAR (2018)*, International Code of Ethics for Professional Accountants, issued by the Council on International Standards of Ethics for accountants (International Ethics Standards Board for Accountants – IESBA),* CECCAR Publishing House Bucharest
[3] Dascălu, R. (2020), *Why is the mandatory manual of accounting policies and procedures necessary in Romania?* Available at https://accace.ro / *accessed on March, 1*
[4] Deaconu, A. (2009)*, Fair Value, accounting concept ,* Economic Publishing House ,Bucharest
[5] Duțescu, A. (2002), *Guide to understanding and applying International accounting standards, Second revised edition ,* CECCAR Publishing House , Bucharest p. 65
[6] Feleagă N. (1999), *Preface to the paper Malciu L., Creative accounting*, Economic Publishing House, Bucharest,
[7] Groșanu, A. (2013), *Creative Accounting ,* ASE Publishing House , Bucharest.
[8] Jones, M. J. (2010), *Creative accounting, fraud and international accounting scandals. John Wiley & Sons*.
[9] Law no 82 (1991)*, Republished Accounting Law*
[10] Law no. 227 (2015), published in the Official Monitor no.688 with subsequent and completions
[11] Malciu L. (1999), *Creative accounting,* Economic Publishing House, Bucharest, pag. 16-17
[12] Mulford, C.W., Comiskey, E.E. (2002), *The financial numbers game: detecting creative accounting practices*, New York: Wiley

[13] Naser K. (1993), *Creative Financial Accounting: its Nature and Use,* New York, Prentice Hall,

[14] Nicolaescu, C., Risti, L., Tăgăduan, D. (2015), *Study Regarding the Quality of Accounting Information Under the Conditions of Using Creative Accounting,* Journal of Economics and Business Research, vol. XXI, nr. 1, Ed. "Aurel Vlaicu"University , Arad, pp. 182-190

[15] *Order of the Ministry of Public Finance no. 1802/2014, for the approval of the Accounting Regulations regarding the individual annual financial statements and the consolidated financial statements, published in the Official Monitor no. 963, with subsequent amenandments and completions*

[16] *Order of the Ministry of Public Finance no. 3781/2019 on aspects related to the preparation and submission of annual financial statements and annual accounting reports of economic operators to the territorial units of the Ministry of Public Finance and for the regulations of certain accounting aspects, published in the Official Monitor no. 5, January, 2020*

[17] Parker, J., Ang, L., Koslow, S. (2018), *The Creative Search for an Insight in Account. Journal of Advertising, 47(3), 237-254*

[18] Sen D., Inanga E. (2009), *Creative Accounting In Bangladesh and Global Perspectives,* The Association of Accountancy Bodies in West Africa Journal, 1, 2009, pag. 27-42.

[19] Professional Standard 21 (2011), *Accounting Mission and Presentation of Financial Statements*, fourth edition , CECCAR Publishing House , Bucharest

[20] Professional Standard 37 (2011), *Enterprise evaluation mission ,* CECCAR Publishing House, Bucharest

[21] Stolowy H. (2000), *Comptabilite creative Encyclopedie de Comptabilite, Gestion et Audit,* Economic Publishing House , BucharestSvabova, L., Kramarova, K., Chutka, J., Strakova, L. *(2020), Detecting earnings manipulation and fraudulent financial reporting in Slovakia. Oeconomia Copernicana, 11(3), 485-508*

[22] THE WORLD BANK (IBRD), *Efficient and transparent financial reporting in business resource in electronic format available at* : https://www.worldbank.org/en/news/feature/2013/10/01/effective-and-transparent-financial-reporting-is-good-for-business/ *accessed on February , 2021*

[23] Vladu, A.B., Amat, O., Cuzdriorean *D.D.* (2016), *„Truthfulness in Accounting: How to Discriminate Accounting Manipulators from Non-manipulators", Journal of Business Ethics. 1-16*