

THE ISSUE OF CREATIVE AND AGGRESSIVE ACCOUNTING IN FINANCIAL MANAGEMENT

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Abstract: Creative accounting is a legal way to "beautify" the overall image of a company. It is a creative approach to the interpretation of tax regulations that allow it. Often, you can come across legal loopholes that open the way to such actions. Unfortunately, there are also companies that decide to use aggressive accounting. It consists of illegal actions, due to which information about the entity shown to people externally associated with the company is incorrect. They mislead the company's perception, and as a result, can lead the company to financial collapse. One of the purest reasons for using both creative and aggressive accounting is the desire to sell the entity or obtain financing. The article was made characteristics of creative and aggressive accounting. The reasons for its practice in enterprises and its causes and significance were shown.

Keywords: aggressive accounting, creative accounting, corporate financial management, financial security.

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Introduction

There are many terms used to describe the manipulation of financial data, examples of which include "creative accounting", "profit regulation" and "controlling the results of reports". However, the most common terms are aggressive and creative accounting. It is common to see creative accounting used as a synonym for accounting fraud. Below are the features of these terms that demonstrate their diversity.

Features of creative accounting:

- creative thinking,
- not breaking the law,
- maintaining the principle of a clear and reliable image,
- maintaining the appropriate property and financial situation of the entity,
- improves the image of the business entity.

Features of tax fraud:

- deliberate misleading,
- planned data manipulation,
- activities that break the law,
- failure to comply with standards and rules,
- camouflaging information about the entity's assets and finances that has a significant impact on the final reception of the financial statements,
- falsification of created information ¹.

In addition to creative accounting and accounting fraud, there is also manipulation in the context of innovative action. It is characterized by unintentional misleading, unintentional violation of rules, standards or regulations, and unconscious manipulation of the financial data of a given entity. Therefore, it cannot be classified as either accounting fraud or creative accounting.

It is worth getting to know the origins of creative accounting and analyzing its history in general. The first definitions of creative accounting could be found in the late 1970s. At that time, it was formulated as "a deliberate policy pursued by management to deceive users of reporting regarding the assets or financial position of an entity". In 1986, thanks to Ian Griffiths' book "Creative Accounting: How to Make Your Profits what You Want Them to Be" ²the concept of creative accounting has become much more recognizable. The author stated that creative accounting is a perfect fraud, due to the fact that it is legal. Since then, many journalists and authors have implemented this term in their works. Many have argued that creative accounting, although not illegal, can be questioned in its morality, because it influences the decisions of people externally related to the financial statements of the entity.

Another important aspect is the fact that in Anglo-Saxon countries the concept of creative accounting was immediately given a negative name. It was considered as deliberate fraud and

¹M. Stanisławska, *Kreatywna rachunkowość a manipulacja danymi*, Wydawnictwa Drugie, Warszawa 2019, p. 38.

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²I. Griffiths, *Creative Accounting: How to Make Your Profits what You Want Them to be*, Pan Macmillan, 1986.

manipulation of financial data, which makes financial statements incorrect. Since then, people's opinions have been divided. Many equate creative accounting with forgery, and many also believe that it is completely non-invasive.

In order to properly understand the processes taking place in creative accounting, its analysis is necessary. It is shaped as the discovery of the needs and intentions of accountants related to the accounting system. Global crises, which cause mass granting of loans despite the high risk associated with their repayment, auditors' opinions on the economic and financial situation of enterprises are the basis for re-analysis of the problem of applying creative accounting³.

In public opinion, the concept of creative accounting is most often defined negatively, which results in a lack of differentiation between creative accounting and accounting fraud. The word "creative" is intended to emphasize the main purpose of using creative accounting, namely innovative action entailing new concepts, ideas or ways of solving problems. It is to be an inventive action that does not disturb the general perception of the individual. It is a conscious choice of the methodology for preparing accounting reports, which should not disturb compliance with laws and legal norms⁴.

Currently, accounting is a comprehensive information system that provides the necessary information about an economic entity. For this reason, the system of transferring financial data without breaking the rules should be constantly improved. New and entrepreneurial activities are most positively sought after in the era of current economic problems. At a time when regulations are constantly being improved and changed, the ability to understand, correctly interpret regulations and act innovatively while observing legal principles and regulations is important.

The area of modern accounting that is most susceptible to creative accounting is the area of financial statement consolidation and merger and acquisition accounting. The reason for this phenomenon may be the fact that this sector is the least researched and analyzed from many angles.

It is often said that higher profits mean higher taxes. This is very dangerous information that can be very misleading. Every company keeps two records of economic events. Tax accounting, on the basis of which tax calculations are made, and financial accounting, which can be found in the financial statements of a given entity. In the case of costs incurred by a company, there are many balance sheet items that unfortunately cannot reduce the company's taxes. A similar situation occurs in revenues. Such differences can be divided into two categories: permanent and temporary. This affects whether a given cost or revenue is considered for accounting and tax purposes in the same accounting period or a later one. An example of such a cost may be making a write-off due to the impairment of inventories. There may be costs that will underestimate the accounting result in a relatively large amount, and it will not be possible to include them in tax costs in

the current or future period. Examples of such costs may be penalties, contractual costs, enforcement costs or budget interest.

Reasons for the occurrence of creative accounting

The general globalization of economic entities and the constantly increasing development of the market economy are the leading causes of the demand for financial information of enterprises. Their accounting, mainly financial statements, are the basic source of information. The reason for the transformation of prospective accounting from retrospective accounting is the growing information needs placed on accounting. This is the imposition of changes in the time perception of the data transferred. ⁵Over time, accounting information is increasingly enriched with predicted and estimated data as well as planned expectations.

In the entire accounting process of a given enterprise, there are many activities and situations that may be ambiguously defined by regulations. In such a situation, the person responsible for maintaining the accounting records of a given entity is obliged to make a decision on the method used or interpretation of the regulations. In an era of many changes and constantly updated regulations, many legal ambiguities may occur. As you can see by analyzing the interpretations and explanations, very similar economic events can be interpreted completely differently. Such situations open up opportunities for creative accounting. When legal regulations leave a choice, it is best to choose the method most beneficial for our entity.

Basing accounting on estimated data means that the clarity and credibility of information ceases to be so important. The existence of creation in accounting, which causes financial data to differ significantly from actual data, is a hindrance. Increasing risks related to decision-making, mainly related to investment issues, mean that this phenomenon exists on a scale previously unseen and can be described as economic pathology⁶.

Doubts about the reliability of the presented financial data are much more noticeable in the context of scandals and economic crises. As is known, tax frauds have been encountered since the birth of accounting, but over time they have become more and more common. The reason for this may also be the fact that the number of audits and verifications of financial statements is significantly increasing and they are becoming more easily detected. The growing scale of doubts about financial data means that potential investors and people externally interested in a given enterprise are becoming more vigilant and attentive when making decisions. The adopted legal regulations do not provide all solutions to tax problems, among other things considering the conditions of functioning of economic entities and the degree of complexity of their business processes.

The reason for the occurrence of creative accounting may be the intention to sell the company or its shares at a significantly inflated value. If the organization of a given entity plans to end the company's operations, the vision of selling the entity most often appears. In order to make this possible with the greatest possible profit for the seller, financial data is often distorted in such a way

³S. Shah , S. Butt , Y. Bin Tariq *Use or Abuse of Creative Accounting Techniques* , International Journal of Trade, Economics and Finance, Vol. 2, No. 6, 2011, pp. 531-533.

⁴O.Amat , J. Blake, J. Dowds , *The ethics of creativity accounting* , Economics Working Paper 199, p. 3.

⁵ME Barth , K. Li, CG McClure , *Evolution in Value Relevance of Accounting Information* , The Accounting Review 98 (1), 2023, pp. 1-28.

⁶M. Szewczyk-Jarocka, *Kreatywna rachunkowość, Zeszyty Naukowe PWSZ w Płocku, Nauki Ekonomiczne*, t. XXI, Płock 2015, p. 37.

that potential buyers are able to pay as much as possible. One of the most common reasons for the occurrence of creative accounting is also a probable or approaching crisis in the company. It can be caused by such grounds as⁷:

- lack of financing,
- incorrect estimation of demand,
- unnecessary investments,
- low profitability,
- unit connections,
- attempting to expand the business without sufficient financial resources.

Factors such as poor reputation or lack of collateral can contribute to the lack of financing. In the current economic situation, low creditworthiness is also a common cause. The bank must have credible confirmation of the ability to repay a potential loan. An entity that wants to obtain a loan should have some collateral, for example, one that can be mortgaged or one that is both liquid and has possibly fixed prices. If such a possibility exists in the entity, funds in market circulation should be reduced.

Planned investments always require prior financing. A specific profit is estimated, thanks to which it will be possible to repay the financing and additional income for the company. In a situation where demand turns out to be much lower than planned or falls very quickly, there is a risk of repayment. In such circumstances, the company should consider restructuring, i.e. selling assets. This is possible only in a specific situation, the entity must have appropriately liquid assets. It is possible to sell stocks of materials that are in market circulation.

The reason for low profitability may be high competition on the market⁸. Until variable costs and unit fixed costs decreasing due to increased production are covered by product prices, the entity has sufficient profitability. However, when costs start to significantly exceed prices, the entity will start to become insolvent. Another reason for low profitability of the company may be the lack of economic conditions. In such a situation, the entity may expect its improvement through the available assets. This is likely if the loss is less than or equal to depreciation. Low profitability of the company will always lead to a loss, in the near or distant period of time. The result is a loss of financial liquidity and, consequently, insolvency of the entity. A possibility of improvement in such a situation is the introduction of external capital to the company.

Mergers of companies are a very complicated activity. Business entities are often bought for an economically unjustified value. Such a value burdens costs, and it cannot be transferred to the price of goods. The benefits of such a merger of entities may turn out to be negligible. Then the costs incurred in the company must be exceptionally limited so that the price for the products is justified.

⁷ B.Remenarić, I. Mijoč, I. Kenfelja, *Creative accounting – motives, techniques and Possibilities of prevention*, Ekonomski vjesnik : Review of Contemporary Entrepreneurship, Business, and Economics Issues 31 (1), 2018, p. 196.

⁸N. M. Stoughton, K. P. Wong, Yi. Long, *Investment efficiency and product market competition*, Journal of Financial and Quantitative Analysis 52 (6), 2017, pp. 2611-2642.

There is no way to indicate specific symptoms through which external entities can directly indicate the occurrence of creative accounting. However, there are several suggestions that may indicate this. If a given entity decides to apply creative accounting by overstating its profit at the end of the accounting period, equity will also be overstated. Overstating equity should always be accompanied by overstating part of the assets or reducing liabilities. This results from the principle of double entry. Companies that want to take a more creative approach to the application of such creative accounting can use the two techniques mentioned above (partial increase in assets and reduction of liabilities that occur on the liabilities side), or they will use only one method, which is certainly more noticeable.

A good way to verify a given company is to analyze its cash flow statement. It is worth noting that net cash flow is difficult to manipulate, but there are many types of techniques that allow for overstating operating cash flows by understating financial and investment cash flows.

Creative vs. Aggressive Accounting Comparison

It is common to see aggressive accounting treated as the same as creative accounting. These terms are often used interchangeably. However, it is worth knowing that these terms differ in meaning. Creative accounting is based on applicable regulations and laws. When these regulations are broken, we stop dealing with creative accounting and aggressive accounting begins.

Aggressive accounting is a deliberate action aimed at distorting the correct reception of financial data of a given economic entity⁹. A person using aggressive accounting is aware of their illegal actions. Manipulating financial data significantly distorts the image of the company. Potential investors are unable to properly assess the capabilities of the entity, which may result in the company falling into a worse financial situation. In addition to improving and correcting the entity's data, there is also often concealment and hiding of part or all of the information in a given sector.

Therefore, the main features of aggressive accounting include:

- illegal activities,
- deliberately misleading customers,
- violation of ethics,
- exceeding accounting rules.

The most common examples of aggressive accounting include activities such as:

- manipulation of financial indicators,
- overstating revenues,
- distorting the company's assets in front of potential investors,
- failure to explain financial risks,
- general misrepresentation of the financial situation of the entity,
- presenting a curved image of the company,

⁹E. Mackowiak, *From behavioral accounting is aggressive accounting*, Economic and Social Development: Book of Proceedings, 2018, p. 159.

— deliberate omission of facts that significantly affect the final financial result,

— change of balance sheet valuation method,
— underestimating costs.

Table 1 Creative accounting and aggressive accounting

Creative accounting	Aggressive accounting
The exercise of the right to choose an accounting policy within the boundaries of the law in accordance with the concept of a reliable and clear picture, in order to present the enterprise's image in accordance with the assumptions defined by the management.	The exercise of the right to choose an accounting policy, the freedom of which is not limited in any in a manner that leads to the manipulation of financial data with an intention to mislead the recipients of information included in the distorted financial statements.

Source: A. Wiercińska, Granice między kreatywną, agresywną i oszukańczą rachunkowością, Prace i Materiały Wydziału Zarządzania Uniwersytetu Gdańskiego No. 2, Gdańsk 2008, p.146.

There are many ways to assess whether a given business entity is dealing exclusively with creative accounting or whether illegal activities are also taking place.

The functioning of creative accounting in the economic space

Creativity is an innovative approach to expressive ideas and concepts. Difficulties can be solved in appropriate and unconventional ways. It is possible to notice constant changes and modifications of regulations. Therefore, it is also possible to constantly use new methods of creative accounting. The concept of creative accounting is very controversial due to the fact that it is associated with the manipulation of the financial result and with the inappropriate use of the possibilities of all accounting principles.

Diagnosis of the frequency of creative accounting in the coming years is not possible in strict execution. In fact, due to very poor access to current information on creative and aggressive accounting, especially on examples of specific companies. This is also due to the fact that, as mentioned earlier, the concept of creative accounting has not been clearly and specifically defined and interpretations of this concept may differ significantly. In practice and literature, creative accounting methods used to improve financial data about the company are titled in various directions. Despite this, one can notice clear trends and restructurings that may significantly affect the occurrence of creative accounting in the coming years¹⁰.

The requirements for clarity and transparency in accordance with tax regulations are constantly growing, which significantly reduces the area for the use of creative accounting. Many companies decide to do such things in order to be able to cope with the current difficult financial situation of the entity. Most countries are constantly modifying their internal standards and tax regulations. They want to limit the occurrence of financial manipulation and creative approaches as much as possible. The most well-known standards are the International Financial Reporting Standard (IFRS)¹¹.

Moreover, technology is constantly developing, and as a result, many processes are being automated. Accounting is constantly changing due to this and may affect the frequency of creative accounting. Therefore, we can conclude that creative accounting is growing due to developing technology, but also due to greater success in detecting tax fraud. IT automation and data precision facilitate and accelerate the processes of detecting creative accounting.

It is worth noting, however, that the occurrence of creative accounting is inevitable. One can only introduce factors that will limit the use of these methods. One can notice a greater tendency to manipulate data in sectors with high market competition or with a strong influence of regulation.

Conclusion

Creative accounting can be called such procedures on the financial data of an entity that are not contrary to tax law, but only use loopholes in the regulations. This is an innovative approach to solving business issues. The most common cases of creative accounting can be seen directly in financial statements. The history of creative accounting in literature dates back to the end of the 70s of the 20th century. This concept already then raised many doubts and divided approaches into different groups. Schematically, it can be stated that creative accounting can be distinguished from aggressive accounting in that it should not arouse legal suspicions. The person responsible for preparing such information must be thoroughly familiar with the applicable regulations and comply with them. Like many aspects, creative accounting has its good and bad sides. The good ones include, among others, innovativeness in action, and the bad ones a less reliable financial picture of a given enterprise. There are many real cases of using both creative and aggressive accounting. The most common reasons include overstating the revenues of a given period or shifting them to a different accounting period than the one they actually concern. Depending on the type of business and characteristics of a given company, there are various possibilities for the application of creative accounting. The predominant method of counteracting aggressive accounting is audits by auditors. The task of auditors is to thoroughly analyze financial statements and assess the validity of documented economic events. Despite the increase in the number and methods of detecting aggressive accounting, a continuous increase in distortions in financial statements can be observed.

The article aimed to compare creative and aggressive accounting and show how companies using it operate. Due to the constant pressure to improve the information provided and the availability of financial data, it can be stated that over time,

¹⁰ A. M. AlShanti, et al., *Exploring the evolution of creativity accounting and external auditors: Bibliometric analysis*, Cogent Business & Management 11 (1), 2024, pp. 17-19.

¹¹ While there isn't a specific IFRS number dedicated to "creative accounting," IFRS 15 (Revenue from Contracts with Customers) and 18 (Presentation and Disclosure in Financial Statements), along with the broader application of IFRS principles, are often used to address situations where creative accounting is suspected or present.

detecting creative accounting will become easier. Consequently, regulations will be able to be modified in such a way as to limit the use of such methods as much as possible. Creative approaches

have always been an inseparable part of accounting books and will certainly not be completely excluded.