

RELATIVITY AND SUBJECTIVITY OF THE ACCOUNTING INFORMATION REGARDING THE FINANCIAL PERFORMANCE

CHILAREZ Dănuț¹, ENE George Sebastian²

Constantin Brâncoveanu University-Pitești

Abstract:

The substantiation and presentation of real, pertinent, relevant and timely information regarding the financial position and financial performance, represents a central element to business communication with the users of financial accounting information. However, in certain circumstances, the producers of accounting information, animated by their own interests and encouraged by the shortcomings of the accounting rules, can offer a subjective image that distorts the reality within the company and leads to the information users' manipulation. The effects of these practices extended to the limit of the compliance rules and accounting principles were noted especially in times of crisis, being known as generating large bankruptcies and financial scandals. The objective of the present paper is to highlight the relativity of the accounting information in general, with an overview of the possibilities and effects of information manipulation related to the financial performance of the enterprise.

Keywords: accounting information, true image, financial performance, accounting normalization, subjective image.

JEL Classification: M41, F30

1. Introduction

Despite the progress made as a result of the accounting normalization and the convergence objectives and uniformity in

¹ PhD Lecturer Faculty of Finance and Accounting,,Constantin Brâncoveanu'' University-Pitești, România, email: dan_chilarez@yahoo.com,

² PhD Associate Professor Faculty of Finance and Accounting,,Constantin Brâncoveanu'' University-Pitești, România, email: george_sene@yahoo.com

accounting, at present, there is continually the question related to the measure in which the information provided by the financial statements is useful and meets the users' needs to make relevant and knowing economic decision.

Although the structure and the content of the financial statements have been continually improved, it should be noted that the usefulness of the accounting information, particularly refers to their quality and less on quantity, being known that sometimes we talk about information that is evidently insincere, imprecise and vague, far removed from their main quality characteristic: true image, can not constitute a real basis to make decisions that are in harmony with their expectations.

If we consider that the accounting information relates to the past, their quality influences both current decisions influence and hence the obtained results and decisions in perspective. To value the quality of the information presented in the financial statements it is necessary for users to know the drawbacks, limitations and risks to such information.

In the accounting theory and practice is still known the degree of uncertainty related to the accounting information, sometimes marked by subjectivism, and the users' manipulation, due to the interaction of the accounting interest to reflect the true image, with other factors related to other reasons that occur in the business.

The reasons for the occurrence and development of the accounting information are justified as being determined by the desire of managers and of other decision makers to provide favourable information to the users in line with their own interests and objectives, financial position and performance of the enterprise. These interests have developed the innovative imagination of managers, supported by accounting professionals, to find different ways of manipulating the information that make up the financial statements.

Manipulating the behavior of the users of accounting information by providing the image desired by the business managers does not necessarily breach accounting rules and regulations, but can be well done within the law, with the help of the ability of professional

accountants. It is called creative accounting. Creative accounting can be determined by the accounting shortcomings of the accounting rules or sometimes accountants are directly or indirectly oriented by managers or even accounting norms on certain subjective professional judgment. The application of specific creative accounting techniques is initiated according to their incidence on the financial position and economic performance and financial enterprise. Although not illegal, creative accounting indicates that managers who are under financial pressure seek solutions without questioning upon the ethics of their actions (Dima 2012).

The strategy of disclosing information related to the financial position and financial performance as well as those relating to cash flows brings special attention as it is a central element of financial-accounting communication. It should also be noted that the objectives of financial statements and accounting system also depend on the accounting system adopted by one country or another, and on the category of enterprises: SMEs, large enterprises or groups of enterprises. In this respect, it is known that the Anglo-Saxon accounting system occupies a central position in formulating the objectives of financial statements, while in the continental accounting system, the objective of financial statements is made of a very general manner, providing a true image.

2. Relativism and subjectivism of the accounting information

Due to the importance of the role played by the financial statements as the main means of communication of useful information to their addressees, their preparation and presentation represents the major current preoccupation of the international and national accounting profession.

As a result of the inherent uncertainties which occur in the development of activities, many financial statements can not be precisely measured, only estimated. At first glance, the international accounting referential provides the accounting professional more

options or estimation techniques to solve a problem, both theoretically and methodologically, richer than the European referential.

The existence of options determines the choice to treat a transaction, a policy or estimates that best fit the specificity and the scope of the enterprise, in order to obtain a true image of the financial situation of the company. Where there are alternative treatments, they open the way to professional judgment to choose the most appropriate means of recognition, measurement and disclosure items in financial statements. However, the international referential does not intend to deal with all the problems, but the establishment of principles and general rules to reduce the differences between the accounting methods and the standards used worldwide, helping to formulate national accounting policies and ensure a high comparability (Guşe 2011).

If we consider that the production of the accounting information takes place within the company, and those who produce it (in practice), and its users (with suspicion), are increasingly becoming advocates of the idea that the company has the option to choose what they can use more advantageously from cost regulations and accounting rules so that the transactions are structured in such a way as to enable production of the desired accounting result, to satisfy their own interest with different effects on the accounting information, including the manipulation of users' behavior.

Such interpretations, justified or not, are also based on the accounting relativism and subjectivism, increasingly debated in theory, with reference to analysis and scenario types, "*creative accounting*", "*financial and accounting engineering*". "*accounting tuning*", etc.

The fears about relativity and distortion of the accounting information can be justified, in particular, by the existence of free choice of accounting policies and accounting estimates in the accounting texts, offering the producers of accounting information the possibility "to play" with the result or to change the company image expressed by the financial statements, without being far from the rules and the accounting requirements prescribed.

Specialized literature includes several approaches, which agree that the accounting information formalized by the financial statements only partially succeeds to fulfill the functions assigned by the normalizers and the users' expectations, but on the subjectivism of the information, opinions are divided in two significant directions.

On the one hand, some opinions say that subjectivity of accounting is inherent, the accounting options have always existed and there is flexibility in the accounting rules regarding the accounting policies, and if applied in good faith it enables a true image of the financial position and business performance and only certain mechanisms can be considered as being practices oriented to creative accounting (Stolowy 2000). Other opinions consider creativity in accounting as a virtue as long as its purpose is to find better methods and more effective solutions to problems, giving it the quality of innovation with an incentive role of the accounting evolution due to the evolutionary process of all social and economic areas. (Malb J.L., Giot H.,1995)

On the other hand, other authors argue that the flexibility of choice of accounting policies, promotes unwanted and misleading practices of accounting information at the limit of standardization, leading to improved information, to embellish the image of the company and the economic and financial performance, and finally, professional accountants use their knowledge to manipulate the figures contained in the annual accounts (Feleagă and Malciu 2002)

With regard to these considerations, we believe that the application with good faith of the accounting rules can not absolutely ensure the satisfaction of the same level of interests of all users of the accounting information (investors, employees, creditors, financial or business, customers, etc.) because each of them tries to use the provided information to meet a particular need or interest.

We can also say that there are indeed some variations and possibilities to manipulate the accounting information regarding the financial position and performance of the organization, as, many times, the flexibility provided by the accounting referentials may be used to satisfy private interests at the expense of users' interest. The most

obvious example is the numerous financial scandals of recent decades which have revealed a series of false and insincere information, due to the incompetence or bad intentions of managers and the business decline, covered by accounting practices and techniques meant to conceal the real situation.

If we consider that the foundation of the information communicated by the enterprise through financial statements is on the one hand the result of a taxation law that allows the development of information with a certain degree of relevance and sometimes quite technical and difficult to understand, and on the other hand, a voluntary offer of information on predictable developments regarding the development, the expansion or the restriction of activities due to the complexity and uncertainty of the economic environment in which the company operates, the quality of the accounting information can be limited by the influence of several objective factors and subjective perceptions of users can print pessimistic or optimistic information presented, which can bring disadvantages in the future. Among the objective factors that lead to such limitations we can mention (Berheci 2010):

- freedom in applying the accounting principles and rules that may generate result intended by accountants and not real information;
- relationship of interdependence between taxation and accounting generate deformations of information in the financial statements;
- numerous usage of the historical cost as a basis of evaluation;
- using estimates to evaluate some elements in the financial statements, resulting in a subjective character;
- synthesis documents contain information covering the past and the decisions they will make users considering future information;
- important information for users are not included in the financial statements since they can not be expressed in money (such as

the information regarding the creative potential value of the personnel);

- prevention to publish information by various companies with regard to their financial statements because they generate competitive disadvantages.

We observe that the production and dissemination of the accounting information is not simply the result of human will and conscience, being in fact a social phenomenon, in addition to objective factors and subjective factors that can be assimilated in some conflicts of interest that arise on the market of accounting information between professional accountants and information users, on the basis of the interaction amid several interest groups promoted by businesses due to various interdependence relations that occur between the board of directors and shareholders, between shareholders and managers, between professional accountants and auditors, placing the issue of impartiality and independence in each interest group.

In this respect, it is worth mentioning the role of the company as an object and a subject of the accounting information, as they are also the ones that allow professional accountants produce financial statements with a degree of relevance for those seeking information, users, whose interests are different. Sometimes, the users' influence and their position in relation to the company, is that they have a privileged status in terms of information, which determines some of them, such as managers, to interfere in the application of the accounting policies and methods and thus, influence the production of the accounting information by professional accountants.

3. Subjective attitude in presenting financial performance

The model used most of the times to reflect the company's performance is formalized through the profit and loss account where we can find the flows that determine the outcome of the exercise and that provide information on obtaining profit or loss.

The accuracy which can determine the result with the help of the profit and loss account is problematic, due to the following attitudes:

- if the definition of a business performance is made through the application of the accounting policies and accounting estimates based on the principles, conventions and accounting rules used for the determination of the result is ade by managers and accountants of good faith, the result may be as realistic as possible.
- if, however, the definition of performance is based on the interest of managers or certain categories of users and accounting professionals resort to methods, techniques, tools, aimed at presenting a favorable financial position and performance of the company, the result can be distorted and the answer is only relative.

The fact that the accounting rules provide alternative options in selecting the accounting policies, it does not mean that they were created in order to manipulate the results or to hide the truth. The criteria for selecting the accounting policies must be specific to each company, in line with the objective to better reflect reality, so as to ensure the credibility and relevance of the information provided.

However, by choosing an accounting policy of the possible ones, more goals can be achieved on the result, such as:

- increase or decrease of current and total operating results;
- minimizing the taxable income;
- increase or decrease of distributable profits.

The motivation of using result adjustment methods, which have a distortion effect on the accounting information regarding financial performance, can be generated by several factors, such as a poor financial situation that worries investors, management failure to comply with the terms in the management contract, the declining evolution of markets, the need for additional financial resources, the establishment of profitable commercial contracts, etc.

In this context, it should be remembered that most of the time, the subjectivity of the accounting information producers goes to the

fiscal cost optimization and it is possible that the determined outcome remain beyond the objective relation of calculation, as the difference between income and expenditure which would offer a relative or apparent character. Such a situation can be achieved due to the existence of factors and conditions that contribute to the distortion of information on the outcome, such as:

- the existence of a connecting relationship between accounting and taxation;
- legislative imperfections, weaknesses and deficiencies of the accounting rules and/or tax;
- limits and/or inconsistencies between certain accounting principles;
- use/non-use of depreciation of the value of the items presented in the financial statements.

The arguments for such behavior can be justified if we consider for example that profits represent the “wealth” of the company and also the return of shareholders after paying taxes. In this context, besides the task to provide treasury cash flows, management bears a fiduciary or contractual obligation to shareholders to make their share of the profits go up as high as possible. In an objective manner, through taxation, the outcome which remains in the company, or returns to shareholders is reduced in direct proportion to the amount of tax rates, and objectivity of the accounting treatment applied to determine the taxable base may be affected by the managers’ subjectivity, so that the value of tax that becomes tax liability generatig cash outflows to remain small.

If we approach the subjective behavior of management on the outcome in terms of tax interest and maximizing enterprise value, the practice has proved that the free choice of the accounting policies meant to achieve the target, can lead to the following possible situations and positioning:

a) the primary interest is that of maximizing the enterprise value, the fiscal side having a secondary influence being accepted as such;

b) the main interest is to maximize the enterprise value, the fiscal side having a major following importance pursuing to reduce tax contributions within the prescribed legal framework;

c) the main interest is the reduction of contributions due to the state as the main objective, despite the maximization of the enterprise value, this situation is known as the “grey area” of the economy, or even the tax evasion.

If these interests are considered in conjunction with the state’s interest as a user (sometimes privileged) of accounting information and if interested, when management is in the position described at point b), then the latter, will ensure that the size and the payment of tax will fall under three conditions: *the least, the latest and legal*, an attitude that comes in contradiction with the state that is interested in all three conditions that refer to: *as much as possible, as fast as possible and as legal as possible*.

To these possible situations, we appreciate that freedom of choice of the accounting policies by the company management, which leads to an increase or a decrease in income, is one of the ways of distortion of information on financial performance and one of the main information limitations of the profit and loss account.

The companies’ behaviour related to the usage of the accounting policies influencing the outcome can be analyzed in terms of two assumptions that imply certain guidelines directed to increase or to decrease results, as it follows (A.Popa 2010):

a). *Hypotheses seeking to adopt accounting methods meant to increase results:*

- Companies in which directors’ remuneration is linked to the accounting result, prefer the methods that have the effect of increasing income, even if it means increasing taxes and reducing cash flow.
- Companies whose dividend distribution rate is approaching the maximum limit set by a contract prefer the accounting methods that lead to an increased output.

- Companies whose debt ratio is close to the limit set by a contract prefer the accounting methods that reduce the apparent indebtedness.
- Companies whose rate of coverage expense with interest approaches the limit set by a contract prefer the accounting methods that result in an increased output.
- Companies whose working capital approaches the limit set by a contract prefer the accounting methods that increase the working capital, in this case the result, because profitability of a business is directly proportionate to the risk of indebtedness and any increased risk to be covered by a result greater confidence to induce creditors and shareholders that they will recover their loans, respectively the investment made by the enterprise.

b). Hypotheses seeking to adopt accounting methods that decrease the result:

- Large companies prefer accounting policies that reduce the result, as the larger the company is, the greater the state's interest is to pursue performance in order to impose additional tax levies, political or social expenditure, all of which affect the result.
- Companies that have a large share of the market or belong to those sectors characterized by high concentration of production and capital prefer accounting policies that reduce their result because the institution is supervised by competition can be accused of monopolistic market and can attract other competitors on the market in which it operates.
- "Regulated" companies under the direct control of the state prefer the accounting methods that decrease their result due to the use of the state capital, may be exposed to careful control on its part and a possible request for additional funding or a change of tariffs would be dismissed in terms of prosperity image.
- The techniques meant to achieve the objectives of adapting the result corresponding to the economic and financial objectives dictated by the company's self-interest may target more

segments of the accounting policies aimed at recognizing and evaluating the accounting alternatives, which offer alternatives that have the effect of increasing or decreasing the result, the current and/or net outcome, resulting in the increase or decrease of income and expense components.

Also, the estimation process involves judgments based on the latest available and the most reliable information, regarding the recognition/non-recognition of possible costs with some degree of uncertainty that would result in the creation of provisions and adjustments for depreciation or loss of the value of assets. These may include: bad debts, obsolescence of assets, depreciation of inventory; fair value of financial instruments, lives duration of the assets, liabilities arising from guarantees, etc.

4. Conclusions

The accounting rules and principles promoted by international accounting normalization was aimed at reducing the differences between the accounting methods and standards used in the world, and an improved comparability of the accounting information to create the conditions to achieve goals so that the information provided by the financial statements is accurate, that is to reflect the real and objective financial position and financial performance. In this respect, with the existing accounting options, we wanted to provide the accounting information producers, a greater flexibility in presenting the best information about the financial position and financial performance.

However, the area of freedom offered by the application of the IASB rules is prolific for the accounting creativity by the opportunity to present in accounts the solution that best fits the interest of the producers of accounting information, without talking about fraud, but only a skillful insertion in the regulatory norm.

The excessive importance paid for the result by the users of accounting information now encourages its representatives to adopt attitudes of “arranging” the image of financial performance, sometimes using “force” to the limit of law, for all possibilities offered by the

accounting referential to achieve the desired result and to meet users' requirements.

The latest developments constantly manifested in the structure and architecture of global markets, "chasing" for profit, on the background of financial crises, give rise at the enterprise level to uncertainties and real concern of the decision makers, which increasingly lead to distortion phenomena and manipulation of the accounting information in order to improve the image of reality using practices meant to "hide" or "embellish" certain situations that would not be favorable, in a way that could lead to the production of the desired result.

Also, the influence of tax rules leads mainly to the interpretation of transactions and economic events in terms of accounting choices that contribute to the optimized foundation of tax base at the expense of the economic substance of the accounting basis.

In these circumstances, if we consider the events and the financial scandals of recent years, related to the violations of the accounting regulations, the scientific character of accounting becomes questionable, as long as one can apply accounting treatments and options that allow recognition and measurement of accounting practices located on the edge of legality, in accordance with a certain goal, which do not always coincide with that of achieving the true image whose effect is difficult to control and fought as long as, even with the best intentions, the accounting regulations provide such opportunities.

The mitigation of the tendencies to resort to such creative accounting practices must remain in the area of accounting normalization by setting clear and precise rules, with limited flexibility, leading to fewer permitted accounting treatments or to clearly established circumstances in which the accounting treatment should be applied.

Besides the subjective manifestations in producing the accounting information, to meet the interest of its users, the role of accounting should be to better reflect reality, so as to ensure credibility

and relevance to the information provided and should neither “hide”, nor “embellish” certain situations and actions.

Even if the company is placed in an uncertain environment, the final criterion in choosing an accounting treatment should lead to the presentation of information characterized by caution, be significant and in line with the economic reality so as to be useful in making economic decisions for all users.

5. References

- Cozian Maurice(1996) *Les grands principes de la fiscalité des entreprises*, 3edition, Litec, Paris
- Cernusca L., (2006) *Politici contabile de intreprindere*, Tribuna Economica, Bucharest.
- Dima F.,(2012) *Contabilitatea creativă prin prisma politicilor și opțiunilor contabile* Revista Anale, seria Științe Economice, vol. XVIII- supliment , Timișoara,
- Feleagă N., Malciu L.,(2002) *Politici si opțiuni contabile, Fair Accounting versus Bad Accounting*, Editura Economică, Bucharest
- Gușe R.,(2011) *Valoare , cost , preț și evaluare în contabilitate*, CECCAR, Bucharest
- Johansson E., Tranberg J.,(2007) *Disconnection between accounting and taxation; possibility or compulsion?* Thesis in business economics, School of Bussines Economics and Law, Goteborg University. Available at [https:// gupea.ub.gu.se/bitstream/2077/3759/1/06-07-80M.pdf](https://gupea.ub.gu.se/bitstream/2077/3759/1/06-07-80M.pdf)
- Lungu C.,(2007), *Teorie și practici contabile privind întocmirea și prezentarea situațiilor financiare*, CECCAR, Bucharest
- Malb J.L., Giot H.(1995), *L'élasticité du résultat selon les dimensions temps et espace*, Congres AFC.
- Malciu L., (1999) *Contabilitate creativă*, Editura Economică, Bucharest,
- Noyer Ch., (2008), *A review of the financial crisis* , Speech at the Hearing before the Finance Commission of the Assemblée nationale, Paris. Available at <http://www.bis.org/review/r081028a.pdf>,

- Popa A.F.,(2010) *Contabilitatea și fiscalitatea rezultatului întreprinderii*, CECCAR, Bucharest.
- Popa, A., (2008), *Criza financiară face ravagii în Statele Unite și Europa*. Available at <http://www.conso.ro/citeste-comentariu/24/info/Criza-financiara-face-ravagii-in-Statele-Unite-si-Europa.html>,
- Stolowy H.,(2000) *Comptabilite creative*, Encyclopedie de Comptabilite, Gestion et Audit, Paris,
- *OMFP 3055 /2009 pentru aplicarea reglementărilor contabile conforme cu directivele europene*, publicat în M.Of. nr 766 bis of 10 November 2009
- *Standarde Internaționale de Raportare Financiară (IFRS)(2011)*, translation from English, CECCAR, Bucharest.