

## CONCEPTUAL BOUNDARIES BETWEEN SUBJECTIVITY, CREATIVITY AND A RELIABLE IMAGE OF FINANCIAL STATEMENTS

**Gabriela CONSTANTIN (ANGHEL)**

IOSUD, “Valahia” University of Târgoviște, Romania

E-mail: expertcontabil@expertiza-anghel.ro

**Cristina-Elena FLOREA (POENARU)**

IOSUD, “Valahia” University of Târgoviște, Romania

E-mail: elena\_1980xyz@yahoo.com

**Mihaela-Raluca BOHARU (MIRCEA)**

IOSUD, “Valahia” University of Târgoviște, Romania

E-mail: ralcont2003@gmail.com

**Abstract:** *The aim of this empirical study is to draw the line between the often unavoidable subjectivity of the professional accountant, and the creativity he has and cautionary employs in preparing and/or certifying financial statements. We turn our attention to the sensitive points of the financial statements, such as the classification of short-term or long-term loans, the recognition of written off debt versus income, or the restatement of uncertain receivables. We wish to clarify the accuracy of financial statements, the extent to which they are influenced by the creativity of the professional accountant and the extent to which the professional's subjectivity affects the decisions of users of accounting information. The purpose of this article is to answer some of the inherent questions which weigh on us, such as: How do we mitigate the damage caused by financial statements whose accuracy has been affected, knowingly or unintentionally? How can we ensure a high degree of confidence in our financial statements? The responsibility for ensuring the conformity and quality of the information presented lies solely with the professional accountant who, by using well-known techniques and methods, which have been adapted to each client, is able to generate highly precise financial statements. The results of the study will indicate the factors that can influence the reliability of the patrimonial image and the implications on the accuracy of financial statements, having the role of leading us in a new direction of research: the possibility of labeling and marking highly precise financial statements.*

**Keywords:** *professional accountant, professional thinking, financial statements, reporting standards, reliability.*

**JEL Classification:** *M40, M41.*

### 1. Sensitive aspects of the financial statements

#### 1.1. The classification of long-term or short-term loans, recognition of prescribed debts to income, restatement of uncertain receivables

The boundary between the subjectivity and creativity of the professional accountant, the prudence used in the preparation and/or certification of financial statements.

Financial statements provide significant information to the business environment, to external users. A detailed analysis of them allows for obtaining certain important details, which lead to the development of the company's activity in order to grow and develop. To this end, forecasts can be made based on the financial and economic history, forecasts that lead to a decrease in the degree of uncertainty on the part of these users and which can produce changes both at the microeconomic and macroeconomic levels.

As long as these companies understand the importance of the quality of financial statements is, they will also understand the needs of external users to receive accurate, highly reliable information. Because any investor or user who has invested in that company is directly interested in detailed reports, in line with reality, so as to provide a smooth running of partnerships.

**The financial statements** are at the meeting point between three main parts: the companies that are the object of these situations represented by managers, the users (we

mention here investors, shareholders, banks, authorities and last but not least the population) and the professional accountant, one of the essential links. Improving the content of financial statements and the credibility of accounting information is attributed to the accounting profession (Berheci, 2006).

Following research and professional experience, we have identified certain sensitive points of the financial statements, among which we recall:

The way in which we classify **short-term or long-term loans**, that is, in particular, a short-term loan agreement of up to one year, concluded with an associate. How should these loans be considered when overdue? How can certain economic and financial indicators be changed by the erroneous classification, intentionally or not, of these loans. Moreover, if the loan is in a foreign currency, the classification may also affect the tax deductibility of exchange rate differences.

Another sensitive point could be the recognition of prescribed debt to revenue. We refer here to debts to suppliers.

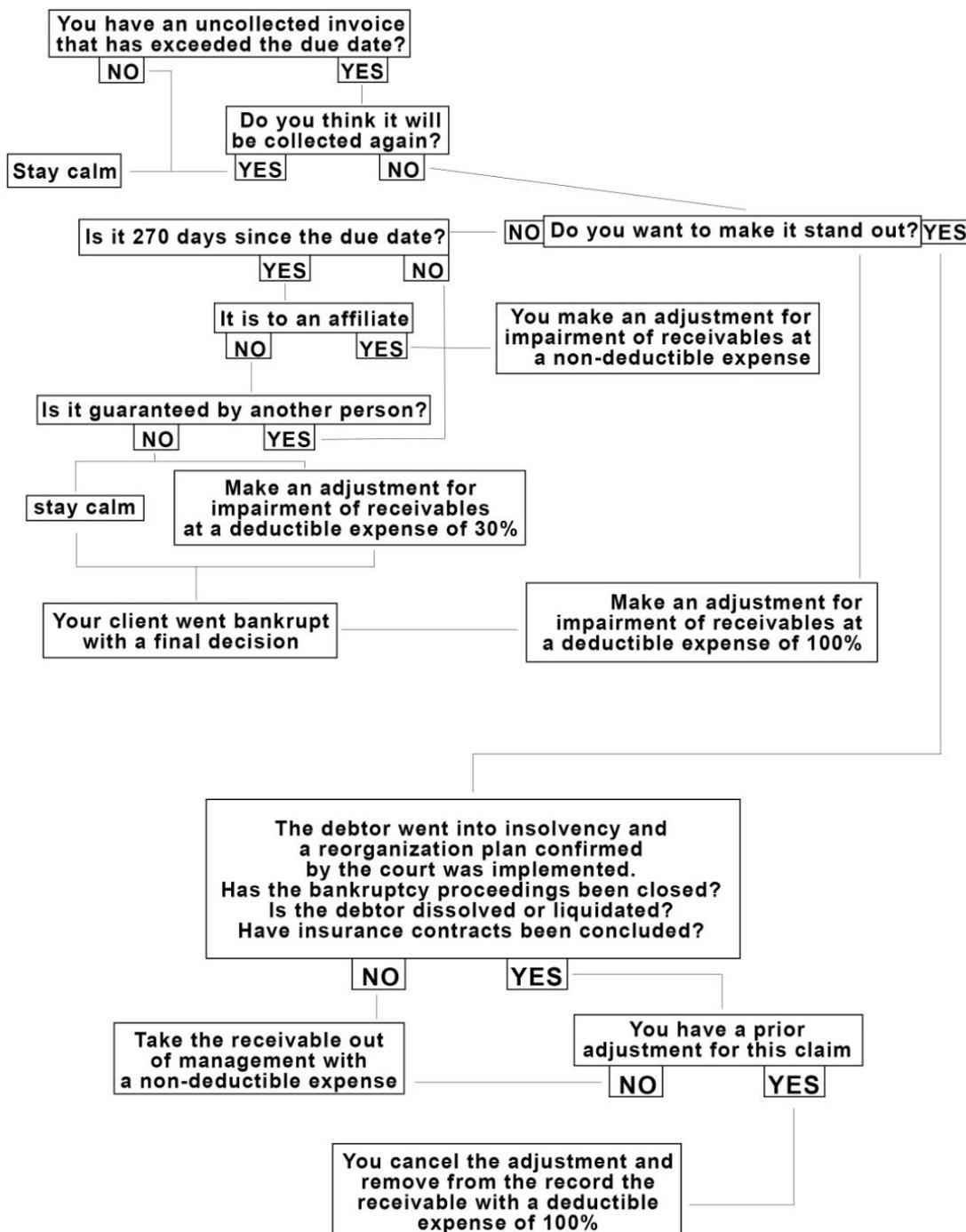
Civil Code, art. 2500 shows that the material right to action, hereinafter referred to as the right to action, is extinguished by prescription, if it has not been exercised within the term established by law. The right to action means the right to compel a person, with the aid of public force, to perform a certain service, to comply with a certain legal situation or to bear any other civil sanction, as the case may be (Civil Code, 2500).

From an accounting point of view, “Point 328 of OMFP 1802/2014 shows that when deducting from the record the receivables and debts whose collection or payment terms are prescribed, the entities must prove that all legal steps have been taken to settle them” (OMFP 1802, 2014).

Another accounting point of view, “Point 28 of Law 2861/2007” regulating the **inventory of assets** shows that receivables and liabilities to third parties are subject to verification and confirmation based on statements of debit and credit balances of accounts receivable and debt that have a value in total balances of these accounts, according to the “Account Statement” (code 14-6-3) or mutual written scores. Failure to comply with this procedure, as well as the refusal to confirm, constitute deviations from the present norms and are sanctioned according to the law (Updated Inventory Law, 2007).

Thus, the professional accountant, by not treating these debts in the situation of prescription to the category of income, can generate fiscal consequences, by increasing the taxable income and, implicitly, the profit or income tax.

Regarding the **restatement of uncertain receivables** “according to the accounting rules”, the valuation rules are very clear and provided by law. The valuation of receivables is mandatory at their probable collection value, during the inventory of the patrimony, at the end of each financial year. In the inventory, the principle of prudence will be taken into account, which stipulates that the entities must take into account all depreciations, regardless of whether the result of the financial year is a loss or a profit. Thus, adjustments for the impairment of receivables are recognized when the inventory value (at the inventory of the patrimony) is lower than the accounting one (at the invoicing). For uncertain receivables, adjustments must be made for the loss of value, at the level of the amount that can no longer be recovered” (Grecu and Grebliș, 2018).



**Figure no. 1. Adjustment of uncollected receivables**

Source: accountantsgroup.ro- Grecu and Grebliș

OMFP 1802/2014 stipulates that the amounts related to **uncertain receivables** must be recorded separately in account 4118 "Uncertain or disputed customers" assigned for customers, and in the case of other receivables, using analytical accounts of those receivables' accounts. However, there are cases in which the professional accountant does not use these adjustments, even if at the date of preparation of the financial statements they find that they will not recover the value of the receivables, they do not record these depreciations that are required due to tax deductibility. We are referring here specifically to corporate taxpayers.

## 1.2 A comparative analysis of financial statements

The main objective of the annual financial statements is to provide information about the financial position of the entity at a given time, the financial performance and cash flows of the entity, information useful to a wide range of users.

We present below the comparative study of the balance sheet items on the basis of which we calculate the main economic-financial indicators, before and after corrections.

**Table no. 1. Comparative financial situation as of 31.12.2020**

Item no.	Name	Balance at 31.12.2020 before corrections	Balance at 31.12.2020 after corrections
1	<b>A. FIXED ASSETS</b>		
2	I. INTANGIBLE FIXED ASSETS	2,802	2,802
3	II. TANGIBLE FIXED ASSETS	29,288	29,288
4	III. FINANCIAL ASSETS	0	0
5	<b>FIXED ASSETS – TOTAL</b>	<b>32,090</b>	<b>32,090</b>
6	<b>B. CURRENT ASSETS</b>		
7	I. STOCKS	79,890	79,890
8	II. RECEIVABLES	468,662	246,110
9	III. SHORT-TERM INVESTMENTS	0	0
10	IV. HOUSE AND BANK ACCOUNTS	119,353	119,353
11	<b>CURRENT ASSETS - TOTAL</b>	<b>667,905</b>	<b>445,353</b>
12	<b>C. ADVANCE EXPENSES</b>	404,191	404,191
13	<b>D. DEBTS: AMOUNTS TO BE PAID IN A PERIOD OF UP TO ONE YEAR</b>	756,202	356,614
14	<b>E. NET CURRENT ASSETS / NET CURRENT LIABILITIES</b>	315,894	492,930
15	<b>F. TOTAL ASSETS MINUS CURRENT DEBT</b>	<b>347,984</b>	<b>525,020</b>
16	<b>G. DEBTS: AMOUNTS TO BE PAID IN A PERIOD OVER A YEAR</b>		186,000
17	<b>H. PROVISIONS</b>		89,416
18	<b>I. INCOME IN ADVANCE</b>		
19	<b>J. CAPITAL AND RESERVES</b>		
20	I. CAPITAL	5,200	5,200
21	II. CAPITAL REWARDS		
22	III. REVALUATION RESERVES		
23	IV. REZERVES	1,040	1,040
24	V. REPORTED PROFIT OR LOSS	145,114	145,114
25	VI. PROFIT OR LOSS FOR FINANCIAL YEAR	196,630	98,250
26	<b>EQUITY - TOTAL</b>	<b>347,984</b>	<b>249,604</b>
27	<b>CAPITAL - TOTAL</b>	<b>347,984</b>	<b>249,604</b>

In order to investigate the influence of the professional accountant's interpretation of the assets (long-term loans, uncertain receivables, overdue debts) on the balance sheet items and financial indicators, we will analyze the case of a company based on the financial statements prepared at 31.12.2020.

In this study, the company had received a loan from associates amounting to 186,000 Lei on 10.02.2017 with a repayment term of one year, but which was not repaid at

maturity. Out of the total receivables of the company, the amount of 311,968 Lei represents uncertain receivables. At the annual inventory of the patrimony, it was found that the amount of 222,552 Lei can no longer be collected because the clients have completed the simplified bankruptcy procedure, and for the difference of 89,416 Lei a provision for litigation should be constituted. Also, once the inventory was performed, it was found that the amount of 213,588 Lei represents the prescribed debt of the company to the suppliers, with the recommendation to be transferred to income.

### 1.3 Interpreting results based on economic and financial indicators

Knowing the level of economic-financial indicators of an economic entity allows comparisons with other entities in similar sectors of activity, domestic or international. In the present research, we aimed to highlight the influence of professional reasoning and the application of accounting rules and policies on the economic **performance indicators** of the analyzed entity

From the multitude of economic-financial indicators that can be calculated based on the data contained in the financial statements, we have selected the main indicators that an economic entity should calculate when it wants an analysis of assets and economic performance. The interpretation of these indicators highlights the risk of insolvency of the entity if the professional accountant makes the corrections mentioned above.

**Table no. 2: A comparative presentation of the main financial analysis indicators**

Indicator	Calculation formula	Pre-correction values	Post-correction values
<b>Current liquidity</b>	Current assets/Current liabilities	0.88	1.25
<b>Fast rate (acid test)</b>	(Current assets-Stocks)/ Current liabilities	0.78	1.02
<b>Degree of indebtedness</b>	(borrowed capital/ equity)*100	0%	74.52%
<b>General solvency</b>	Total assets/current liabilities	0.93	0.13
<b>Financial profitability (ROE)</b>	Net profit/equity	0.57	0.39
<b>Asset rate of return (ROA)</b>	(Net profit/Total assets)*100	28.09%	20.57%

- ❖ A first influence of the corrections on the **liquidity indicators** is highlighted in the current liquidity. This indicator reflects the ability of current assets to be converted into liquidities in a short time to cover current liabilities. After the corrections, the value of short-term debts increased, thus leading to an increased ratio between themselves and current assets, thus guaranteeing the coverage of current debts from current assets, a situation that is much more favorable to society than before the corrections.
- ❖ The second influence is reflected by the **acid test**, eliminating stocks as they cannot immediately turn into availabilities. Literature recommends a value higher than 1, and in the case analyzed only after making corrections, the entity proves its ability to cover its debts.

- ❖ The degree of indebtedness is directly influenced by **long-term debts** and reflects the entity's risk of being unable to pay its debts, its maximum allowed value being 30%. After applying the correction in the case of long-term reconsidered associates' loans, a very high degree of indebtedness results, which shows an increased risk of insolvency, a situation unfavorable to the company.
- ❖ **The general solvency ratio** was calculated, in order to correctly quantify the risk of non-payment of debts to which the analyzed entity is subject. After the corrections, the solvency decreased significantly, thus showing that the entity is approaching bankruptcy.
- ❖ **The financial profitability of the entity**, measured with the ROE indicator highlights the return on equity and should have values over 5%. In the analysed case, it cannot be stated that the activity carried out within the company was efficient from the point of view of the return on equity, the ROE value being subunitary both after the corrections, as well as prior to them.
- ❖ **The rate of return on assets measures** the efficiency of the use of assets, from the point of view of the profit obtained and shows how many Lei a Leu invested in assets generates in the form of profit. According to the case study above, the economic entity is in the safety range, respectively for every one Leu invested in assets, the company obtains in the form of profit 28 Lei if no corrections are made, respectively 20 Lei with the corrected situations.

## 2. A new label of financial statements

### 2.1 The degree of trust

Our proposal consists of creating a matrix that allows the calculation of values based on well-established criteria, each criterion being assigned a degree of importance depending on the influence it has on the accuracy of financial statements. The final goal is to calculate a score based on which the financial statements of a company are included in one of the **4 degrees of confidence**.

**The proposed criteria for the formation of the matrix and their weight in the calculation of the score:**

- ✓ *the rate of automation and digitization of the accounting system* - 15% (values from 1 to 10 are given, 10 representing complete digitization)
- ✓ *the certification of accounting statements by a professional accountant, CECCAR member*: 15% (0 points are awarded for the preparation of financial statements by a non-CECCAR employee, 5 points for the preparation by a CECCAR member who is also an employee of the company and 10 points for certification by an independent CECCAR member)
- ✓ *the certification of the financial statements by a financial auditor, CAFR member*: 15% (10 points are awarded only if the financial statements are accompanied by the independent auditor's report)
- ✓ *the existence of an internal control system*: 10% (10 points are awarded if the administrator's statement proves its existence)
- ✓ *the existence of an internal audit*: 10% (10 points are awarded if the administrator's statement shows its existence)
- ✓ *application of international financial reporting standards*: 10% (10 points are awarded if the IFRS applies to the administrator's statement)
- ✓ *the entity's shares are traded on the capital market*: 10% (0 points for those traded, 10 points for those not traded)

✓ *the degree of trust obtained by the company in the previous year:* 10% (0 points for a limited degree or lack of trust, 5 points for a medium degree, 10 points for a high degree of confidence previously obtained)

✓ *the number of litigations in which the company is involved:* 5% (values from 1 to 10, 0 points are awarded if more than 10 litigations are registered, 10 points for less than 3 litigations)

Depending on the score obtained, the following grades can be obtained:

- **High degree of confidence**, with a score over 90
- **Average degree of confidence**, with a score between 75 and 90
- **Limited degree of confidence**, with a score between 45 and 75
- **Lack of confidence**, with a score below 45

## 2.2 The role of the professional accountant in ensuring the degree of trust

The professional accountant is the person who, according to the Government Ordinance no. 65/1994, has passed the entrance exam, completed the three-year professional training internship and passed the aptitude exam at the end of the internship, organized according to the regulations issued by the Body of Expert Accountants and Certified Accountants of Romania (CECCAR).

Based on the professional reasoning intertwined with the experience and knowledge of economic-financial analysis, evaluation, control, audit, informatics, strategic management, professional ethics, the professional accountant capitalizes on the information in the interest of the company.

The defining characteristic of the accounting profession is the acceptance of responsibility and risk-taking in substantiating decisions based on knowledge and in accordance with the legislation in force.

International education standards require professional accountants to acquire and maintain the skills of ethics and deontology in achieving the main objective of meeting the requirements of the public interest through professionalism, trust, credibility, ensuring the highest quality standard for all missions, especially that of certifying financial statements.

According to the National Code of Ethics for Professional Accountants, they must observe the following fundamental principles: integrity, objectivity, professional competence and prudence, confidentiality, professional conduct and respect for technical and professional norms.

Professional accountants must comply with the relevant legislation and professional and technical norms issued by: International Federation of Accountants (IFAC), International Accounting Standards Board (IASB), CECCAR, the Chamber of Financial Auditors in Romania (CAFR).

## 3. Conclusions

The main objective of this research was to establish how the subjectivity of the professional accountant or his creativity affects the accuracy of financial statements. The question to be answered is whether an entity's financial and economic performance indicators are influenced by professional judgment and whether the application of specific international standards and professional standards would lead to increased confidence in financial statements.

Therefore, this study showed us that professional accountants have a major **role** in ensuring the quality of financial statements, but also the fact that more creativity or subjectivism can distort the true image of assets. To support users of financial statements, we have proposed a grid for evaluating them to determine the **degree of confidence** that an entity's financial statements can gain.

Also, the defining characteristic of the accounting profession is the acceptance of responsibility and the assumption of risks in the substantiation of decisions based on knowledge and in accordance with the legislation in force.

The information provided adds **value** to the entity and the way in which this added value is measured depends on it.

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