

audit FINANCIAR

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10/2016

- Dezvoltarea conceptului de audit social în România
- The development of the social audit concept in Romania



- **Importanța raționamentului profesional în contextul aplicării Standardelor Internaționale de Raportare Financiară**
- **Studiu privind tehnicile de contabilitate creativă în contabilitatea managerială**
- **Aspecte privind impactul evoluției ratei dobânzii asupra probabilității de nerambursare**

- **The importance of professional judgement applied in the context of the International Financial Reporting Standards**
- **Study regarding the creative accounting techniques in management accounting**
- **Aspects of the impact of interest rate development on the probability of default**

Un profil conceptual privind controlul

A comprehensive conceptual profile on control

Sumar / Content

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10/2016

Ioana Iuliana GRIGORESCU, Camelia Daniela HAȚEGAN

- *The development of the social audit concept in Romania* [Click here!](#).....1101

Sorin DOMNIȘORU, Radu OGARCĂ, Cosmin BĂLOI

- *A comprehensive conceptual profile on control* [Click here!](#).....1114

Ionela IVAN

- *The importance of professional judgement applied in the context of the International Financial Reporting Standards* [Click here!](#).....1127

Flavius-Andrei GUINEA

- *Study regarding the creative accounting techniques in management accounting* [Click here!](#).....1136

Luminița Gabriela ISTRATE, Bogdan Ștefan IONESCU, Monica HARALAMBIE

- *Aspects of the impact of interest rate development on the probability of default* [Click here!](#).....1149

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The development of the social audit concept in Romania

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Abstract

The paper mainly approaches the social audit, an insufficiently developed field in our country. The social audit concept is defined in Romania by the Social Assistance Law no. 292/2011 and its application is limited to this scope. At international level, the concept has a much wider application area.

The research methodology is a qualitative one. The objectives of the paper consist in the theoretical development of the social audit concept: the definition of the social audit, the description of the stages and the goals of this process, the identification of the connections between sustainable development, corporate social responsibility and social audit, the performance of a comparative analysis between the social audit, the financial audit and the internal audit, the explanation of the advantages of applying the social audit in the business environment, in social institutions and in the public administration, the illustration of qualitative and quantitative indicators that can be employed in social audit engagements, as well as the proposal of an application model of the social audit in Romania.

Keywords: *Social audit, corporate social responsibility, sustainable development, financial audit, social indicators*

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Introduction

Emerging democracies face significant difficulties in the economic and social field, as well as in the field of the democratic administration. In the private environment, we can say that the capitalist society understands the economy in terms of economic return and is based on values which not always respect the ethics, or the environment, while it is not always aware of the social responsibility.

In the public environment, though political leaders have been elected by means of democratic methods, the implemented social policies often don't entirely represent the needs and expectations of the citizens, while civil servants don't efficiently manage public funds, or are not sufficiently transparent and responsible in front of the citizens they serve. We can say that the "culture of transparency" between public and social employees is lacking.

In the last years, however, in Europe and all over the world, more and more companies are willing to take social responsibility, by honest practices, a transparent management and an environmental friendly development.

In the same line, the citizens are more and more demanding in respect of their right to be informed and have an influence on the decision-making. The number of "ideological customers" is increasing every day. All these lead to the need of a methodology to examine the coherence between the actions of the companies and public institutions and the values of the social economy.

The term "audit" refers to several types of audit, including social audit. The social audit is an instrument that supports distinct entities to evaluate their corporate social sustainability actions, in order to observe the extent to which they managed to reach their social goals. It can be applied both in the public and in the private environment.

Our research started from the fact that the social audit concept is almost unknown and not used in Romania.

The objectives of the present paper are to describe and develop the social audit concept in Romania, to clarify and raise the awareness of the role of the social audit in the current social and economic context, to bring arguments in favour of the idea that the use of the social audit has positive effects on the economic and social

environment, as well as to describe the performance of a social audit and propose an application model in Romania.

A developed society is assessed based on the nature and the quality of the social services provided to its citizens. Hence, an increased transparency is necessary in all fields of both the public and the private economic and social life.

1. The origin of the social audit concept

The term "audit" appeared in England, in the late 13th century, in relation with the financial and accounting field. In the 20th century, the activity of the auditors from the United States of America expanded to the social area. In this line, Howard Bowen published the book "Social responsibility of businessman", where he stated that business men are responsible in front of the society and they must follow strategies in connection with social objectives (Idowu, 2015).

In Europe, the social audit concept was first used in the 50s, through the radical ideas of George Goyder, who in 1961 published the book "The responsibility company". Later, in 1973, John Humble released the work "Social responsibility audit: A management tool for survival".

The social audit becomes popular in Europe. In England, the association Social Audit Limited publishes its results in the journal "Social Audit Quarterly", while in France the Social Expertise and Audit Society is founded, who contributed to the establishment of the International Institute of Social Audit.

2. The definition of the social audit in literature

In order to assess the companies' and stakeholders' possible interest in the social audit, we need to perform several conceptual clarifications of the terminology used in the specific international literature, where we find a high number of terms like: social responsibility accounting, corporate social reporting, social audit, ethical statement, values report, social statement, social account, ethical audit, memoria sobre desarrollo sostenible, balance societal, auditoria social, audit social (Morros and Vidal, 2005; Mugarra, 2004).

In the literature of the 80s-90s, we find different authors concerned with the social audit, authors who defined and differentiated the social audit from other audit types. In this line, Vatier (1980) defined social audit as a “management and administration instrument, as well as an observation attempt that, unlike the financial or accounting audit tends, in its area, to assess the ability of an organization to manage human or social issues generated by its environment, as well as raised by itself by using the necessary personnel in performing its activity”.

Spreckley (1981) notes that “the social audit is a concept related to social enterprises and represents an evidence of their social character”.

Candau (1985) considers it “an independent and inductive objective undertaking of observation, analyse, evaluation and recommendation, which is based on a methodology and uses techniques that allow, in relation with different explicit references, the identification, in a first stage, of the strengths, the problems generated by employing the personnel, as well as of the constraints, in form of costs and risks”.

Zadek and Raynard (1995) consider that the social audit represents, in a more complete form “a process that allows an organization to evaluate its social efficiency and ethical behaviour in relation with its objectives, so that it can improve its social and solidarity results and account for them in front of the stakeholders.”

The preoccupations in the field of the social audit continued after 2000, attracting the attention of the European institutions. In this line, the European Commission (2001) defines the social audit, in its Green Paper, as a the systematic evaluation of an organisation’s social impact in relation to standards and expectations;

Roqueñi and Retolaza (2005) specify that the meaning of the social audit can differ between the countries. For instance:

- The social report or “balance societal”, used in France, refers to “all the initiatives that, in a direct and systematic form, with criteria established in time, seek to describe the operating manner of the firm in the social environment”, while
- The memorandum on sustainable development, i.e. “memoria sobre el desarrollo sostenible”, used in Spain, refers to “information provided voluntarily by an entity, in order to inform about its social actions;

- The term social audit or “auditoría social”, also used in Spain, means “the external verification of the information provided within the social report, based on a previous regulated process”.

Igalens and Peretti (2008) perceived the social audit as a form of observation, or a logical reasoning and defined it more thoroughly, i.e.: “a form of observation that aims to test the principles, policies, processes and results associated to the relations between the organization and its partners, if: it actually accomplished what it stated; it used its means in the best possible way; it preserved its autonomy and wealth; it is able to accomplish what it intends to accomplish; it observed the rules; it knows how to assess its risks”.

In Romania, Şchiopoiu Burlea (2008) defines the social audit in the book “Social audit from theory to practice” as “a complex, objective, independent and inductive process, through which the social reality from an organization is observed, analysed and evaluated based on its efficiency and performance criteria, as well as according to the internal and external regulations in force, for the purpose of amending its weaknesses and removing the social risk factors”.

Chivu (2006) briefly describes the performance of a social audit and provides examples of reference indicators used in human resources management.

Our qualitative research showed that the Romanian literature is not abundant in papers on the topic of the social audit.

Within Romanian regulations, the term “social audit” is referred to in 2011, within the Social Assistance Law no. 292/2011. Paragraphs 1-4 of art. 142 prescribe that: “Private suppliers of social services, contracting authorities, as well as other natural or legal persons who finance social services, may require the independent evaluation of the funding agreements for the provision of social services, by means of social audit procedures. The social audit is performed by the social auditor and considers mainly:

- a. The examination of the plans and procedures defined by the suppliers of social services for the funded services;
- b. The evaluation of the efficiency and effectiveness of the contracted social services;
- c. The examination of the accuracy of the employed information;
- d. The recommendation of operational improvements.”

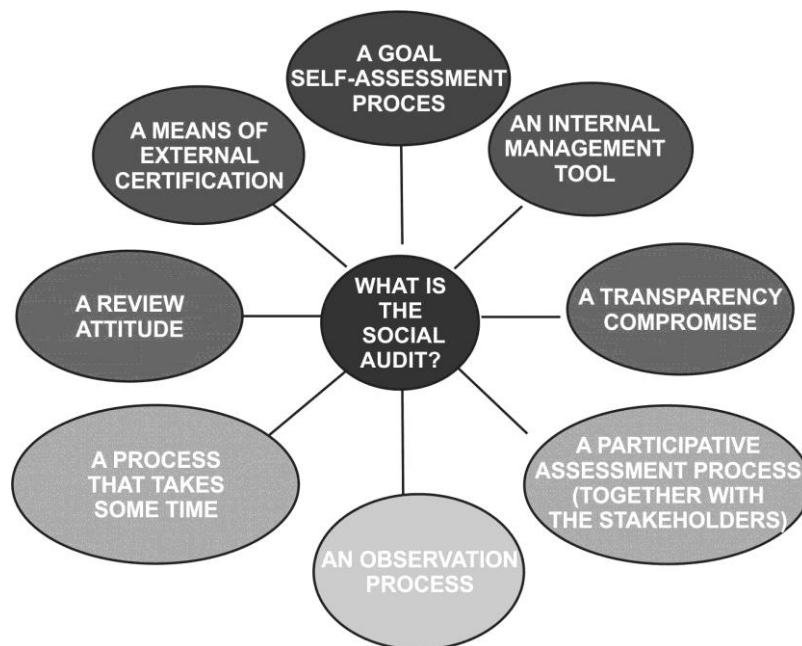
The definition of the social audit, proposed in Romania by Law no. 292/2011 doesn't include all the social responsibility issues, considered in the international literature, but regards merely funding agreements for the provision of social services by private suppliers; yet, the social audit is a general instrument of the social responsibility, a management tool, and can be employed by any type of public or private organization.

We accept the idea that social entities must be the first ones to adopt or employ the social audit in their internal management, due to the fact that they are based on

social objectives and one of their preoccupations should consist in the continuous improvement of these objectives. But the social audit supports any type of organization to measure its social results, in five different areas (Spreckley, 1981): profit contribution, human resource contribution, public contribution, environmental contribution and product/service contribution.

Figure 1 summarizes the point of view of different authors, who attempted to define the social audit concept:

Figure 1. What is the social audit?



Source: Authors' own processing, 2016

After analysing these definitions, the social audit is, in our opinion, a continuous evaluation process, that can be integrated in the regular activity cycle of a company – planning, evaluation, reporting – and can be considered an essential condition in the achievement of the entities' and organizations' progress and concessions with the society they belong to.

3. The research methodology

The research methodology is a qualitative one. We performed a review of the Romanian and foreign

literature – textbooks, books, papers and specific regulations in force. We accessed relevant websites and electronic databases, like the ones of the European Commission and of certain public and social institutions from Romania and from abroad. Based on the collected data, we described the evolution of the social audit at international level, as well as a description of the current state of the art in Romania. More, we shall explain the implications of the social audit in a private institution or company, in order to prove that its use has positive effects on the economic and social environment.

4. The role of the social audit – the relationship between sustainable development, corporate social responsibility and social audit

The question to be asked is the following: Why should companies and stakeholders be interested in the application of the social audit?

Currently, a frequently debated topic is that of the sustainable development, which implies the solving of global issues of the social and economic life and can be realized only through the active involvement of all companies. The pillars of sustainable development are the economic, social and environmental development (Anghel, 2009).

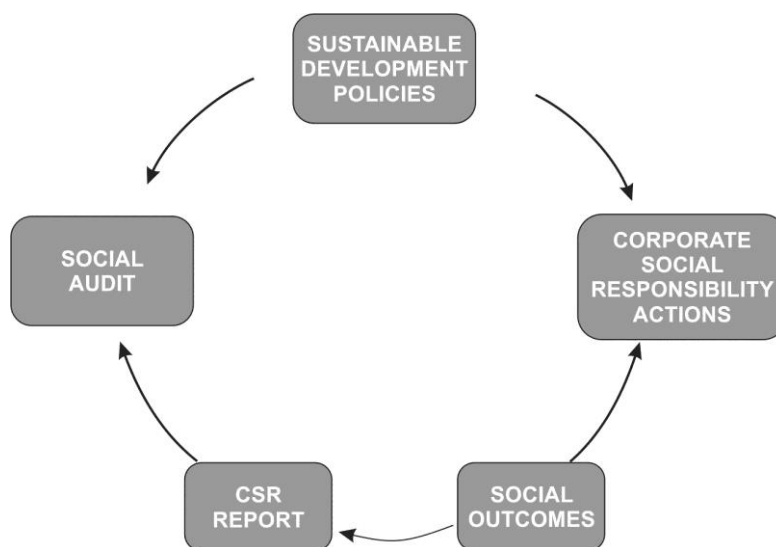
In Romania, social responsibility reports are not a priority (Bunea, 2013). National companies initiated the adoption of social responsibility policies when they aimed to be listed on the Bucharest Stock Exchange, given the covenants of its Corporate Governance Code. More, the prepared reports don't really describe social responsibility strategies, the application results of such strategies or, least of all, corresponding improvement measures.

The term “corporate social responsibility” has been used in Europe since the early 21st century and its importance has increased in time. In 2011 the European Commission issued a new definition of the corporate social responsibility, according to which CSR means “the responsibility of enterprises for their impact on society”. Hence, a new approach emerges, implying the voluntary integration of the enterprises’ social and environmental concerns in their trading activities, as well as in their relationships with the stakeholders, thus contributing to the conciliation of the economic, social and environmental responsibilities in the cooperation with their partners.

The corporate social responsibility (CSR) activities of the companies must comply with their sustainable development policy. *And this is the point in which the social audit starts playing its role. The social audit tests the coherence between the corporate social responsibility activities and the sustainable development policies of the company, aiming at the improvement of its social and environmental performance.* This leads us to the necessity of the social audit.

The evaluation and continuous improvement process of the sustainable development policies, as well as of the corporate social responsibility actions of the companies should be performed as briefly illustrated in **Figure 2**.

Figure 2. The relationship between sustainable development, corporate social responsibility and social audit



Source: Authors' own processing, 2016

For a better understanding of the role played by the social audit, we shall provide several examples of sustainable development policies and corporate social responsibility actions:

a. Sustainable development policies:

- In the economic area: declining poverty, providing access to utilities, funding the infrastructure;
- In the social area: supporting families with more than one child, assuring labour security, supporting people with disabilities;
- In the cultural area: access to education, quality of information;
- In the financial area: pension covering, business ethics;
- In health: access to medicine, whose costs are partly covered from public funds, eradication of diseases;
- Ethics: respecting human rights, fight against the corruption, proficient governing.

b. Corporate social responsibility actions:

- The involvement of all organizations in activities associated with the economic and social development of the society;
- Investments oriented to the welfare of the community;
- Transparent business, transparent actions;
- The non-acceptance, as partners or collaborators, of firms supporting the production of arms;
- Policies of employee promotion and training;
- Ethical business;
- Social programs for diabetics, orphans, drug-addicted persons;
- The granting of scholarships for underprivileged pupils;
- Supporting the environment-related research etc.

As a conclusion, the role of the social audit is to:

- Evaluate the sustainable development objectives that have been set;
- Examine if the corporate social responsibility actions that have been set are correlated with the sustainable development policy of the entity;
- To evaluate the performance of the company;
- To examine the information provided by the entity's Social responsibility report;
- To detect possible shortcomings;
- *To provide recommendations related to the detected shortcomings, so that the attitude of the organization in the economic, social and environmental field is continuously improving.*

5. Comparative analysis between the social audit, the financial audit and the internal audit

The annual reports of the organizations provide mainly financial information. It has been considered lately that non-financial information is also required, in order to deliver a more complete information and to raise the confidence of the users in the provided reports. Hence, at European level, the Directive 2014/95/UE was approved, which commits public interest companies with over 500 employees to publish a non-financial statement, comprising "information regarding at least environmental matters, social and employee aspects, respect for human rights, as well as anticorruption and bribery issues". Financial information is thus the object of the financial audit, while non-financial information is the object of other types of audit, like the social audit. The internal evaluation of the organization's activity is performed by the internal audit.

As a consequence, we shall analyse the similarities and dissimilarities between the social and the financial audit, identified and summarized in the following table:

Table 1. Features of the social, financial and informal audit

Feature	Social audit	Financial audit	Internal audit
Responsible international body	Social Accountability International (SAI)	International Federation of Accountants (IFAC)	The Global Institute of Internal Auditors (IIA Global)
International standardization	SAI SA8000 Standards Social Accountability	International Standards on Auditing (ISA)	Internal standards on internal auditing
International standardization implemented in Romania	No distinct professional body identified*	ISA endorsed by the Chamber of Financial Auditors of Romania (CAFR)	Standards endorsed by the CAFR, in collaboration with the Association of Internal Auditors
Objective	The evaluation of the social performance of an organization's activity	Expressing an opinion regarding an organization's financial statements	Evaluating the governance, risk management and internal control processes
Users	Stakeholders	Stakeholders	Management
Independence	Compulsory requirement	Compulsory requirement	Compulsory requirement
Audited period	Set based on an annual plan	Usually, the financial year	Set based on an annual plan
Periodicity	Annual or shorter periods	Annual	Annual
Compulsoriness	Voluntary	Prescribed by law and voluntary	Prescribed by law and voluntary
Completion	Report with findings and recommendations	Report expressing an opinion	Report with findings and recommendations

* Several organizations provide in Romania SA8000 evaluation services, among which the Romanian Society for Quality Assurance issued most certificates, within the certification scheme SA8000 of IQNet Ltd
http://www.saasaccreditation.org/sites/default/files/u4/CB_By_Country_Q1_2015.pdf

Source: Authors' own processing, 2016

In the last years, in Romania, concerns for studying the social audit activity were shown by the Institute of Social Economy, which is a program of the Foundation for the Development of the Civil Society, initiated and developed within the project "PROMETEUS – Promoting the social economy in Romania through research, education and training at European standards", co-financed from the European Social Fund, through the Sectoral Operational Program Human Resources Development 2007-2013¹.

The table above shows that no professional body has been established in Romania, meant to manage the social audit activity; the international association SAI accredited however several certification organizations from Romania; hence we may conclude that a national professional body could be founded in the near future.

Based on the information presented, we consider that all the specified audit types are necessary, so that they contribute to the certification of a more complete image of the outcomes of the organization's activity, in order to

raise the confidence of the users in the reporting. More, the auditors of the information could collaborate and rely on each other's activity.

We shall further on detail the social audit process and the identification methodology of the social audit indicators, with the latter's illustration.

6. The social audit process

The social audit is a method or an instrument of the company's internal management. It is assumed that no company will counterfeit its own self-assessment process, but if the company claims that a publicly available social audit report should be issued, in order to raise its credibility, the report should be certified by an external independent person.

Depending on the purpose of the social audit and on its objectives, the audit can be performed by an internal auditor, an external auditor or an audit team, established within the company and proportionally representing all the stakeholders.

¹ <http://www.ies.org.ro/ies-1>

According to Șchiopoiu Burlea (2008), the stages of a social audit engagement are the following:

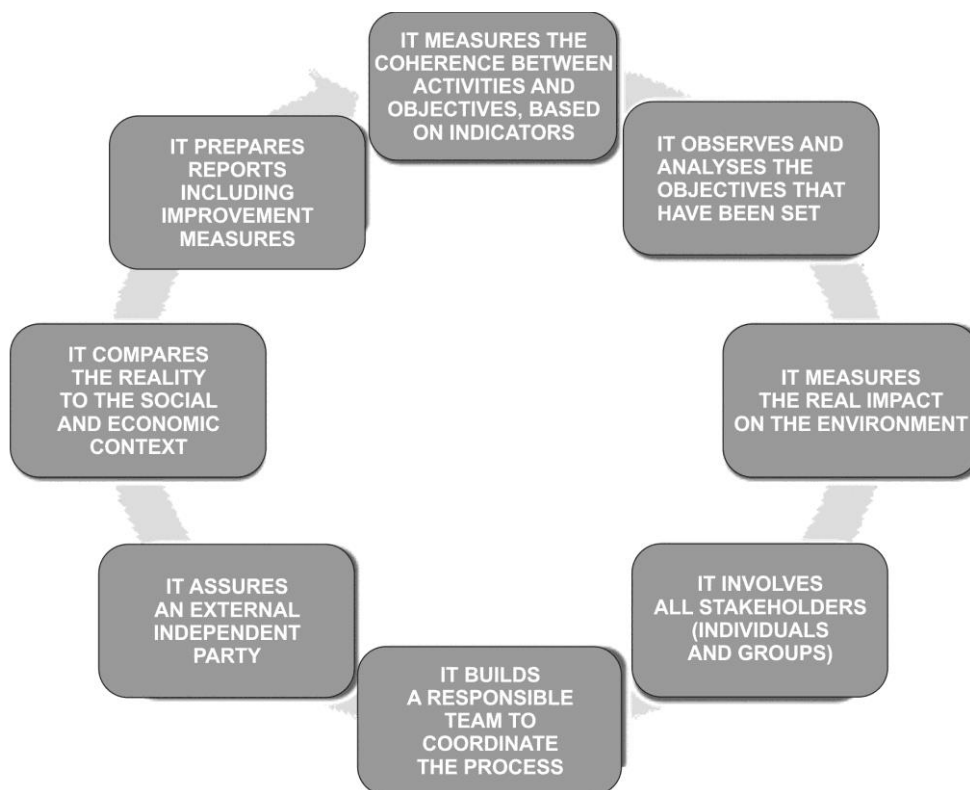
- The pre-diagnosis stage, which includes: The description of the (internal or external) social audit engagement;
- The localization and understanding of the entity – especially by the external auditor;
- The detection of the entity's real problems;
- The drafting of a Working plan;
- The information collection and control stage;

- The information analysis stage;
- The information testing and validation stage, within which the audit report is also prepared;
- The recommendation stage.

We can notice that the above identified stages generally resemble the other audit engagements previously compared; it is incidental that audit engagements have the same general rules, just a different content of their activity.

The figure below summarizes the social audit process:

Figure 3. The social audit process



Source: Authors' own processing, 2016

The necessary elements of a social audit of good quality can be:

- Sufficient motivation on the part of the company;
- Consensus and a direct participation of all the stakeholders;
- A correct information with regard to the objectives of the social audit;

- The existence of an audit team from inside the company, which covers proportionately all the interested groups;
- The determination of adequate indicators for the objectives under evaluation;
- The involvement of external participants, with the ability to monitor the audit process, in order to

provide consultancy if needed and in order to certify the validity of the methods and instruments employed, as well as the representativeness of the participating parties.

The social audit is a process that requires a preset time – like a year or several months – depending on its objectives and indicators. It is a process that must follow several logical procedures, starting with the the initiative of performing a social audit – proposal, approval, organization of the process – up to its real execution.

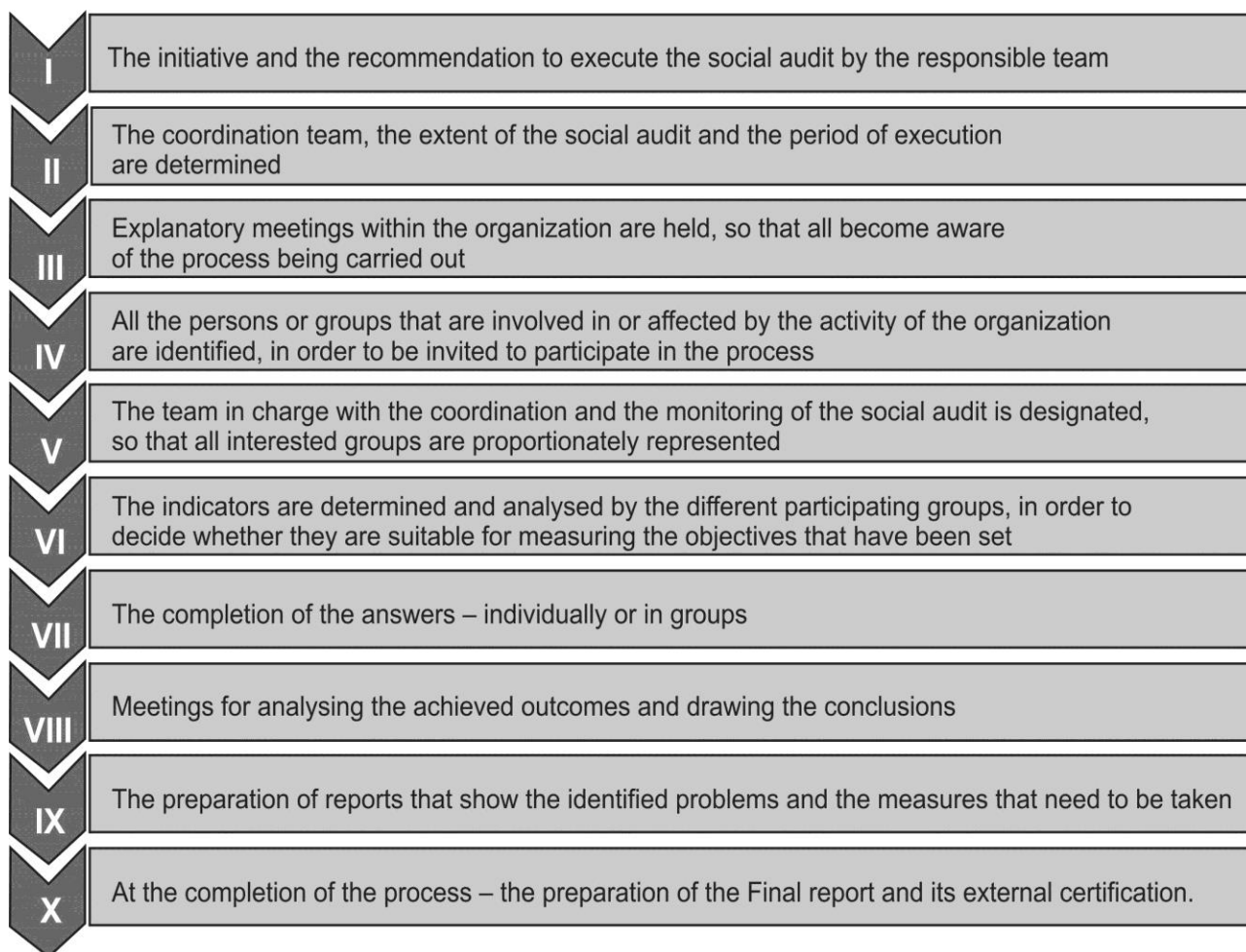
If the social audit is performed by the group comprising the different persons or groups, who are either involved in or affected by the activity of the

entity, the responsible team will execute the planning and coordination, as well as determine the calendar and the indicators of the social audit, while the rest of the actors:

- Will respond to the determined indicators, individually or in groups;
- Will participate in the meetings at which the indicators will be interpreted;
- Will suggest improvement measures, based on the outcomes of the audit.

The social audit organization stages could be the following:

Figure 4. The social audit organization stages



Source: Authors' own processing, 2016

7. The social audit indicators

Most companies don't start from scratch but have own methods, based on which they gather information or opinions, or reflect on elements with no pure economic content, but these methods are fragmented and poorly structured.

The social audit relies on what already exists and builds on it until an integrated and logical structured is achieved. Most organisations are surprised to discover that they had been performing many social audit elements, however without completing them.

We suggest following the following methodology of identifying social audit indicators:

Figure 5. Indicator identification methodology

WHAT ARE INDICATORS USED FOR?	<ul style="list-style-type: none"> • For measuring the quality and the quantity of the CSR actions • For comparing
WHAT DO THEY MEASURE?	<ul style="list-style-type: none"> • The goals and the values of the organization, related to the ethical behaviour, the compromise with the society, with the environment etc. • They carry a dialogue with all persons and groups who are involved in or affected by the activity of the organization – shareholders, investors, employees, associated firms, the state, the local community etc.
WHAT DO THEY REFER TO?	<ul style="list-style-type: none"> • To the products and services provided by the organization • To the social impact of the organization
HOW DO THEY MEASURE?	<ul style="list-style-type: none"> • In terms of quality – the manner, the form, the intensity of the social compromise, the level of satisfaction, the perceptions of those involved in or affected by the activity of the organization etc. • In terms of quantity – they quantify, based on the indicators, proportionately, globally etc.
WHAT DO THEY MEASURE WITH?	<ul style="list-style-type: none"> • It structures in concrete questions all the aspects composing each objective which will be evaluated.

Source: Authors' own processing, 2016

The social indicators are meant to synthesize the information collected during the social audit engagements and extract the core of the phenomena. Therefore the social auditor, based on the own judgment and logic, needs to choose those indicators whose evolution can be followed for a time "for using them as

efficient instruments of the social policy" (Șchiopoiu Burlea, 2008).

We shall further present several concrete examples of questions or indicators identified in literature, which can support any type of organization to test if its activities reflect the ideals and values it promotes.

Figure 6. Examples of indicators

TYPES OF ORGANIZATIONS THAT CAN APPLY THE SOCIAL AUDIT	EXAMPLES OF QUALITATIVE INDICATORS	EXAMPLES OF QUANTITATIVE INDICATORS
<ul style="list-style-type: none"> Public and private social institutions: The Red Cross, Associations of Retired Persons, National Health Insurance Institutions, Pension Insurance Institutions, Labour and Social Protection Institutions, public and private residences, orphanages, foundations, associations, retirement homes, NGOs, etc.; Public institutions: from the field of education, culture, health, city halls; Private firms from the field of transportation, trade, cleaning, maintenance, financial, consultancy and training activities, agriculture, industry etc. 	<ul style="list-style-type: none"> Whether the products and services provided by the organization have a contribution in raising the quality of life; Whether the organization has a critical position with regard to the excesses of the society; If there is a proper information flow inside and outside the organization; If the employees participate in the decision-making referring to their work, or the future of the organization ; If a particular attention is paid to labour quality (protective clothing); If efforts are made for the improvement of the employees' qualification; If the organization supports or is sympathetic with underprivileged groups or regions; If the suppliers, clients or collaborators of the organization apply environment protection policies; If an ethics related criterion was applied at the selection of the bank the organization works with; If the selective collection of the waste is practiced. 	<ul style="list-style-type: none"> The quantity of recovered or recycled materials; The amount and the quality of the products sold and the services rendered; The number of trained employees/year; The amount of granted credits; The quantity of food that was donated to underprivileged groups; The number of granted scholarships; The number of complaints against the organization; The number of cut jobs; The difference between the highest and the lowest wages within the organization; The quantity of re-used water; Costs associated to environment protection; The number of papers or publications on environment protection, released by the organization; % of the profit oriented towards benefaction projects.

Source: Authors' own processing, 2016

Conclusions

The development of the social audit concept in Romania is extremely important, as its application contributes to:

- Improving the quality of the social services in Romania;
- Developing a socially involved environmentally responsible business environment;
- Guaranteeing that the fundamental rights and principles of the employees are respected – the payment of a decent salary, the labour health and security, the absence of discriminations, the right to association and collective negotiation etc;
- Improving the quality of the services rendered to citizens by the public institutions;
- Respecting the right of the citizens to control those governing the country and representing their

interests, or the right to participate actively in public actions, in order to raise the quality of life in our country;

- Increasing the transparency in all sectors of the public and private, economic and social life from Romania;
- Generating an new cultural attitude of the Romanian citizens, of more active involvement in the public and social activities.

In the attempt to build a more steady and sympathetic society, what is important in Romania is both the theoretical development of the social audit concept, and the introduction of several elements from the practice of those who have already been applying social audit.

The truth is that, as presented in the international literature, the social audit is a complex process, which takes time and is quite costly. The information amount

that can be provided by a social audit report is large and able to respond to the requirements of different types of stakeholders.

As prescribed by the Social Assistance Law, the social audit can be performed in Romanian social institutions by a social auditor, whose characteristics and responsibilities will be determined by law. But what would be the alternative to the external certification of the social audit in Romania, for the other types of public or private institutions?

In our opinion, one option could be the certification of the social audit reports by a public institution, based on previously determined criteria. With public institutions we mean, for example, a department established within city halls that would have the advantage of a good knowledge of the local economic and social environment, as well as of the rapid certification, due to the proximity to the organizations from the region. The risk associated to this option would be that the local administration prescribes criteria which would not be sufficiently relevant for a certain sector.

Another option, perhaps more interesting than the first one, could be a combination between the local administration and the professional bodies from different sectors. This option would have the advantage that the professional bodies would be able to identify the most suitable indicators for each sector, while the certification would be provided by the local administration, as an external representative, with real credibility, which could evaluate the social actions of the organizations.

For the beginning, several experimental engagements could be performed, at the level of some city halls; these could be subsequently generalized, based on the concrete experience gathered.

The issues we presented had a purely theoretical character, which might decrease the relevance of the research; yet our main objective was to debate the approached topic and to suggest theoretical solutions. The research can be continued, as a future direction, through a practical approach, in order to validate the solutions we proposed and to identify possible corrections, in order to perform a qualitative social audit.

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A comprehensive conceptual profile on control

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Abstract

The paper starts from the persisting uncertainties regarding the use of the term “control”. In order to mitigate such ambiguities, after a brief subject exposure, a range of questions are proposed, whose adapted answers may help us to refine a correct understanding and perception of control, of course in relation with a plethora of similar concepts.

Our argumentation includes the elaboration and presentation of a range of conceptual pillars or vectors regarding the control in its widest meaning, in contrast with other more restricted forms, equivocal or even altered explanations. The text is enriched with some assertions of the authors regarding the assurance of the appropriate control, with its meaning of a state of harmony, which can successfully meet honest expectations.

At the end, we conclude that, in the current conditions, control can only be defined in a holistic style and we proposed a conceptual profile, through which we can easily explain what the control actually includes.

Keywords: Control, undulating, management, risk, administration, controlling, audit, review.

JEL Classification: M00, M10, M14, M42, M49

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Introduction

Scientific literature and legislation, as well as everyday language of professional practice, include ambiguities and contradictions regarding the use of the notion of control, a concept which is still not clear enough. The reasons are extremely diverse and one can still find improper uses of similar concepts, such as: audit, inspection, review or verification, check, research, assessment, controlling, management control, analysis, etc.

The normative field is extending permanently, the opinions regarding the concepts amplifies and are equivocal or even contradictory, becoming a source of inspiration that is not always the best. Conceptual failures are frequently interpreted in a subjective and even abusive manner, hence it result dangerous speculative situations.

There is no unanimous point of view on the content of control in scientific literature and one cannot see signs of such a state being reached in the foreseeable future. Supporting this idea, we consider that it is enough to mention the definition provided in Dicționarul de Management (2011, p. 3) [Management Dictionary], which states shortly, concisely, but inefficiently that control is, by nature, an ambiguous term. Around this elegant caution, we aim at defining a range of vectors that may help mitigate the equivocal description.

Our approach is not casual and it starts from the perspective that any respectable publication in the field begins with or includes consistent explanations on the content of the key terms. This effort is made precisely in order to mitigate the risk of erroneous understanding, interpretation and use. The hereby presentation does not contain trenchant, absolute answers, but rather perspectives, suggestions on some interrogations.

1. Research methodology

The article proposes an exploratory and descriptive research. The investigation aims to better clarifying the content and use of the notion of control, so that specific equivocation can be reduced.

To this purpose, we have used a range of tools that are specific to a quality-based, constructivist research, implying an interpretative approach of the reviewed subject. Thus, the paper starts from the study of particular literature and legislation, as a basis for drawing up the conceptual profile, by using objective examination and

eloquent contrast on a soft issue, that was not approached in an open manner, but rather in a cautious one.

The combination of theoretical ideas with the authors' experience has helped us perform a cursive and persuasive presentation that inductively and deductively supports the proposed control profile and the resulting conclusions.

Based on self-interrogation, on reasoned answers and inherent adjustments, we have undertaken a rich contextual and transversal exposition, outlining a significant part of what control may mean. Based on logical reasons and deductions, exposed of course to the risks of subjectivity, we have tried to define control in a better and most concise manner, possible and likely to be used by interested specialists.

2. A retrospect on relevant literature and attempts at conceptualisation

Since our concern is to clarify a conceptual sequence, we have decided to work by drawing up a range of questions – according to the queries found in the scientific literature and throughout the practice – whereby answers could be provided:

1. When did control appear?
2. What is control: an attribute, a principle, a process/action, a tool/device or a function, a range of elements, a state, a certain atmosphere, a social relation?
3. Are there differences between control and controlling, between internal and management control, between managerial and organisational control, between control and verification? What about between control and inspection, control, evaluation and audit, audit and monitoring?
4. Is control or rather control & assessment one of the attributes of management? Do they have the same content? How can this attribute be better defined?
5. What field is control positioned in: accounting, finance or management?
6. Who holds control in a business unit: the General Assembly of Shareholders, the supervisory board or the executive management? Or who holds control in a democratic republic: the parliament, the government/prime minister or the country's president?

Of course, the list of questions may continue, but it is our aim to focus only on these and attempt, hopefully, to answer in a most accurate and eloquent manner. However, before answering questions and exposing concepts (recognising that we are talking about a complex notion, it is our belief that a complete and relevant presentation is not possible otherwise) on the content of control, we think that some explanations on the meanings assigned to the word “control” in Romanian language and their use may be useful for further referencing along the presentation. In principle, they are as follows (DEX, 1998, p. 221):

- Of dominating a situation, a process, a system or an area, a structure, organisation or population, etc. If we were limited to this explanation of control, all problems would be solved, but we also have the meaning:
- Of checking the regularity or the compliance regarding the performance of a project, process or result, compared to pre-established requirements/objectives, with a view to discovering possible deviation and/or abnormalities.

The same ambiguity is found at an international level. For instance, in the 60s, Rathe (1960) identified more than 50 different meanings of “control”. Henry Fayol drew up a first definition of the control of a business unit a century ago: checking whether everything is applied according to the established plan, to the orders that were transmitted, to the principles that were predefined. The purpose of control is to identify deviations so as to correct them and prevent them from happening again (Fayol, 1949).

The Merriam-Webster British dictionary emphasizes the current meaning for control: dominating, leading, while the Larousse French dictionary primarily presents control as review, inspection or survey and only then as domination or ruling.

It is seen that meanings are not identical at all and we appreciate that this semantic situation is the main cause of uncertainties.

In terms of harmony, it should be mentioned that the abundance of checks may result in an extreme form of control, namely a dictatorial domination, but this situation may only be classified at the opposite pole, as being very imbalanced, contrary to proper control.

However, if we only talk of internal control and, for instance, only analyse it along internal audit, defining it

as a function/task of investigation and assessment of functionality, efficiency and quality of the (specifically) internal control (of which internal audit is a part), we see that things get complicated and some clarification is needed.

Our concerns are not new. Almost three decades ago, Simons (1990) outlined many uncertainties on the same topic: “We need, in fact, a better language to describe management control of the processes. Control systems are used for multiple purposes: monitoring, learning, signalling, constraint, surveillance, motivation and others. Yet, we use a single descriptor – management control systems – to describe these distinctly different processes. Eskimos use precise word to describe different types of snow and sailors have specialized words for ropes that perform different functions. Management control theorists also need a precise vocabulary to develop and communicate the concepts necessary to describe their complex organizational phenomena”.

We shall try to clarify these things in an original, challenging manner. This being added, we try in the following to answer the proposed questions

Regarding **the first question**, on when control appeared, various viewpoints can be found in the scientific literature, with more or less objective arguments, dating the appearance of control back to about several centuries up to a millennia. The same Merriam-Webster British dictionary shows the first attested use of the term “control” in the 15th century. The term comes from the Latin “*contrarotulare*” which meant comparing various papers to official documents kept in the form of a roll-up/rotulus (Adair, 2013, p. 32).

Considering the evolution of management as a science, which has ended by referencing itself to biological systems and the fact that the notion of control is related to all beings (not only to humans), it is our belief that this concern, under various forms, has existed in fact since life appeared on Earth. To this purpose, examples in the animal reign, where each group has a leader, who stays as such as long as it can hold control on the concerned group, are obvious. Similarly, one may say that the matriarchate and the patriarchate are archaic, but obvious and relevant forms of social organisation – of control implicitly. Elements of power, influence and interest appear here, which exist, but which cannot be seen as separate from control; on the contrary, we may even say that they intertwine. Control is an attribute of

power (and management is an essential component of the latter); influence and interest have common elements that strongly overlap and interfere; we may say that, the better they combine, the greater the “architect’s” power is. After 1960, behaviourists used to see control as a power-based concept and, unlike the classical management school which only saw power in terms of hierarchy and formal authority, they had a wider approach thereof (Parker, 2013). Could this be the important part of the difference between the control as domination and the control as review/verification?

Thus, at a social level, the concept of control arose with the first forms of leadership, more precisely as a component thereof. At an organisational level, the control appeared and developed as an activity in full awareness, premeditated and organised with the emergence of the scientific management. Capley (1974) saw control as its “central idea”, while Taylor considered it to be the “original object” of its experiments.

Beyond these chronological benchmarks, the control as a practice is influenced by social, economic, technological evolution. The theorists face the challenge of identifying the fundamental, immutable principles, beyond the contingency practices developed in certain contexts (Berry et al., 2009).

Since **the second question** is extremely large, we think that it is useful to provide our view: the control is not necessarily placed in a bi-univocal relation with some system of inspection or follow-up. Any verification may be declared as a control (however, in order to reduce ambiguities, the situation should be avoided), but control is not/does not always mean a review. In our opinion, control is the proper answer for the following question: what can be done in order to manage the activities and persons, wealth and risks, results and perspectives, in a much wider way than any review/verification.

We are based on the ideas drawn up by COSO (Committee of Sponsoring Organizations of the Treadway Commission), which proposes a fundamental control framework, somehow ordering this vague complex of means and practices that every individual uses in order to best manage his/her activities and reach his/her objectives.

The definition proposed by COSO mentions as follows: control is a process implemented by the administrative/supervisory/management board and the staff of an organisation, aimed to providing reasonable

assurance on the achievement of goals. From our point of view, we should notice that the use of the word “process” restricts the content and we add that this control is also implemented with the participation of third parties (funders, authorities, external auditors, suppliers and customers, etc.). We hold (after Renard, 2003) three elements of this definition:

- Control is undertaken by all employees/stakeholders;
- It does not only refer to the business ecosystem;
- We are dealing with the relative: control is not a magical potion that helps us to work “perfectly”, but just one of the means that help us work better.

After COSO, the challenge was launched and kept gaining field. The Canadians took over in 1995, when they published COCO (Criteria on Control Committee), providing the following definition of control: the elements of the organisation (including resources, systems, procedures, culture and tasks) that together can help achieve the objectives. We notice a short, apparently less clear explanation, but one that is extremely comprehensive. The definition supports another control framework, with the following features: universality, prioritization of the means, relativity and the fact that the framework does not develop by itself.

Regarding the two definitions famous in the scientific literature, we should underline that, while COSO focuses on actors, COCO focuses on the implemented means; however, we appreciate that, not by accident, the COSO control framework was taken over by the International Auditing and Assurance Standards Board of the International Federation of Accountants.

Other definitions were added to these historical concepts; they are not contradictory, they just specify the concept: “a complex permanently implemented by the officers of an organisation in order to ensure the proper performance of its activities at all levels with the purpose of achieving goals” and/or “the joint organisation of means that tend to ensure the proper control of an operation” (Renard, 2003).

We think that it is not appropriate to use the word “control” in defining control, but this definition managed to tell everything about control in just a few words. In this context, we believe that the definition offered by the Government Ordinance no. 119/1999: “all the forms of control exercised at the level of the unit, including the internal audit, as established by the management according to its objectives and legal regulations, with a

view to ensuring economic, efficient and effective fund management; it also includes organisational structures, methods and procedures” seems somehow incomplete, for instance because:

- It is mostly focused on control’s economic side, to the detriment of other elements such as career or talent management, whereas many employees do not perceive their relationship with the employing entity as a pragmatic one, but as an emotional one;
- Does not say explicitly, does not even induce anything on the organisation’s management profile and/or state of spirit, on its culture and the environment it operates in, on the quality of the stakeholders and shared organisational rituals, etc.

We appreciate that an adapted definition of control could be the state of domination and involvement, of moderating and enhancing a certain entity/issue. The positive meaning of control implies that this “domination” does not take place chaotically, randomly or at one’s discretion, in a despotic manner, but according to properly defined performance criteria, that are known within and at least in proximity.

On the other hand, we appreciate that the term “rigour” would be closer to the truth, as a synonym of control as domination, starting from the assumption that, while the system and processes fall within a decent rigour – with no culture of suspicion, but with a perfect accuracy – they also become easy from an operational point of view, in terms of autonomous maintenance within normal operating parameters, in correlation with strategic objectives.

This concern is more and more obvious given the decentralisation of the decision-making process, in order to ensure the relevance and quick implementation of such a state/situation. Organisations with several hierarchical layers cannot optimally operate without enough delegation of authority and responsibility. Decisions are made at lower hierarchical levels even within an excessively controlled organisation. In these conditions, the general manager will normally ask questions on the width and quality of the control exercised by himself/herself and his/her collaborators upon the entity’s operation and results. Moreover: “functions in charge with risk and control not only require employees with technical abilities, but also simple members who show creativity, assertiveness and flexibility in a fast-changing business environment” (Brüggemann et al., 2015).

To this purpose, we can also discuss the so-called state of control. It is represented, positively speaking, by the trust or comfort provided to a person by the organisation and operation of the referenced entity, i.e. the proper organisation and establishment of relations in order to achieve goals. This does not exclude control processes, but should not be mistaken by them. The state of control is produced, or, in better words, induced by the specific format and spirit of order adopted by the referenced entity and by the (in)actions of the involved. In other words, we are talking of an atmosphere and a climate primarily ensured by the organiser, as well as a social relation between all stakeholders, also between the referenced entity and the universe it acts within.

In our view, control means to take over and maintain the initiative, to establish goals, to keep the structure, atmosphere and the required order to achieve the desired results. Control and initiative, creativity, though equally important for organisational success, are often seen as antagonistic. Spekle, Van Elten and Widener (2014) using the Simons’ theory on levers of control, that we will refer to thereafter, examined the relationship between the control system, empowerment and creativity. Based on a survey on a sample of 233 managers, they found that there is no conflict between control and creativity per se, but, paradoxically (the term belongs to the mentioned authors), creativity may be stimulated in the presence of a “balanced” control. It is thus how we end by recognising the obvious: control is both a principle for building systems, for performing processes and following results, and a function, a certain atmosphere and everything that is listed in the second question, which should be undertaken mainly by the management, if they want to sustainably achieve positive outcomes.

Naturally, every answer may be enlarged upon, but we shall try to provide shorter answers for the following questions. As for **the third question**, we can thus simplify and say that there are bigger or smaller differences between the stated notions: between inspection and review – with the latter being wider and differently positioned; between audit and verification – the first is much more comprehensive; between management control and organisational control – the latter has a wider meaning; there is a completely different relationship between internal control, management control and controlling – they are similar concepts, that may be considered to refer to the same

concept, but they come from different cultures; certain shades appear from here, but they are not quite clear differences. Practitioners and theoreticians developed, professional bodies were established and controlling standards were drawn up in German-speaking countries. In Guenther's opinion (2013), differences between controlling and management control are not determined by the fact that they are concepts from different organisational realities, but rather by the national, regional cultural differences in understanding and adopting management control at an organisational level. The more or less same coordinates are adopted by Pavlovskaja and Kusmina-Merlino (2013), though the differences identified by them between management control and controlling seem to be more numerous and essential. However, in our opinion, the essence is that all listed categories are part of control itself. Moreover, it includes many other formal and informal elements.

With a minimum development of the explanation, we observe that some authors (Horváth & Partners, p. 7-15 and 242) underline that "controlling is many times falsely considered to be synonymous to control" and we subscribe to their proposal. For instance, in a Romanian context, Mocanu (2014) does not seem to differentiate the terms. According to Horváth & Partners (2007) "controlling was created through an interesting combination of knowledge resulting from the automated adjustment theory and accounting knowledge in an organisation (...), while control, which is much wider, is focused on the achievement of all the goals and functions of an organisation". In the view of the mentioned authors, controlling "is responsible for the accuracy of collected and transmitted information". Information should be correct, detailed enough, respectively synthetic: complete, timely and available at the right place/with the right recipient, etc. We would say that it is responsible at least for these objectives. Supporting this idea, according to Guenther (2013), controlling is the German word for the management control system. However, control is also responsible for the way of thinking, beyond the individual field of activity, in the meaning of interference management.

4. The issues raised by the fourth question are again exposed to equivocal interpretation. It should be said that this issue is mostly raised in Romanian literature. In Anglo-Saxon literature, management has the following functions: planning, organizing, leading, controlling. In French literature, management has the following

functions: planification, organization, direction and contrôle. We observe that, in both situations, there is no other association to the term of control. Scientific publications oscillate between expressing the last attribute of management as: control-assessment for most authors (Robbins and Coulter, 2002) and the attribute of control as domination for less of them (Ionescu and Cazan, 2007, p. 267-268; Renard, 2013; COSO etc.). The explanation is somewhat simple. Giglioni and Bedeian (1974) consider that every definition of management control usually involves two dimensions: one is related to the approaches taken in order to direct the activity of subordinates according to certain guidelines, standards, principles, and the second deals with the assessment of the outcomes of such approaches and the performance of corrections, if required.

Practically, for a long time, the definitions of control were touched by a cybernetic view, i.e. they implied performance standards, performance measurement, comparison of performance with standards, feedback and system adjustment. Almost 30 years ago, Green and Welsh (1988) underlined the fact that, in their opinion, cybernetics was the basis for control in any system, i.e. the foundation that all definition thereof should be based on (and the recognition of control as a regulatory system). The cybernetic view still persists in management literature, at least in Romanian one.

In this context, we consider that the group supporting the control-assessment attribute envisages the proper delimitation thereof from the other management attributes/functions, but cripples its content, limiting it to the level of a simple monitoring system – follow-up, review and reporting; we have already emphasized that the notion/attribute of control implies much more.

There is still the issue of a clear delimitation of control as a management attribute from the others; this may indeed suffer, but we consider that this limitation is less important in this case. Thus, most works approaching contingency factors of management control include, among them, the methods to organise work and, respectively, coordination systems at an organisational or, more recently, cross-organisational level (see, for instance, Whitley, 1999).

Ouchi (1979) outlined the existence of an interdependence between control and the management's motivation function. Going through a wide literature in the field of sociology, social

psychology, organisational theory, he believed that the various forms of assessment and control resulted in various commitment levels or even individual alienation from the organisation and its objectives.

Simons (1990) reviewed the literature on strategy and management control and concluded that there is a relation between how companies achieve competitive advantage, organisational design and the use of management control within an entity, i.e. he talked of a dynamic relation between strategy and management control. Since strategy is one of the goals of the management's planning function, we can thus talk of an interdependence between control and planning.

Therefore, may the extremely exact delimitation of control from other management attributes be relative, since it is still a sequence of management attributes? Or does the surplus of management control (even more the organizational control) compared to control-assessment result from the very combination of all attributes (Green and Welsh, 1988)? In our view, this seems to be the most plausible and correct statement that we may make and sustain. Green and Welsh underlined the idea as follows: "Control is instantiated in organizations in complex ways. Usually it is embedded in a variety of systems and often it is coupled with other organizational processes."

As a support for our statement, we should also mention that the classical functions of management are more and more frequently re-analysed, re-interpreted in the latest years. For instance, Nelson and Economy (2005) consider that, even though the classical functions of management are still valid, "that does not tell the entire story". Managers can no longer command and control in a Taylor/Ford-like manner, they should instead create an environment that encourages employees to perform as good as possible, to be deeply committed to the objectives of the organisation. For the achievement of such goals, managers should fulfil new functions such as incentive, empowerment, support and communication with employees. In the vision we aim at inducing, **control** has since long overcome its status as a regulator, passing to the phase of genuine **undulating**, in strong interference/concurrence with risk management. This implies that a leader and/or manager presses, even forces sometimes, when things do not go according to the expectations and there is an acceptance to that, but they relax when the atmosphere/persons no longer can take additional

pressure, independently of the results; they go rather towards involvement and (re)motivation than other stricter elements.

Therefore, the answer to **the fifth question** comes naturally: we agree that the presence of control is everywhere and in everything. However, for a clearer approach, let us state the question differently: how can a professor hold control of his/her students in a class or how did a Greek orator hold control of the agora? There is no accounting or financial knowledge/ability involved in these cases. First of all, we are dealing with the charisma of the orator and lecturer and, second, with the auditorium's interest in the content of the discourse. The list of elements required for holding control, in a more or less elegant manner, could continue without problems, but, transferring at the level of business units, we are keen on underlining that this is a mere example, though suggesting a very clear image on the perspective that finance experts and accountants should have, of who does control belong to. As with any profession, there is an inherent dispute among economists on which group/profession/person is most important?! It is true that holding or not holding control is a recognising criterion for the accountants (IFRS, 2015), but that does not mean at all that it would be primary for takeover from management control. The economic recognition criterion rather stems from the legal area and, therefore, it is not substantial enough for assigning control to the area of accounting, even though we can talk of accounting control, as of financial control, and they both are required, but as parts of management control. What one can most do is underline that it has been established as being ensured in accounting to a larger extent, but this only shows that it can be more accurate, due to its nature and to its specific tools.

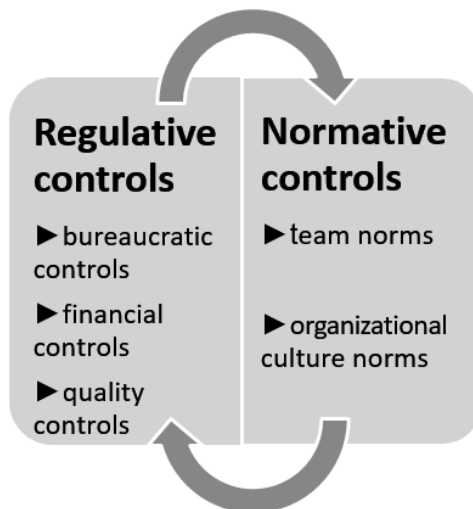
Anthony (1965) is the one who introduced management control as a distinct field of academic debate and education. He broke down the control into three distinct processes: strategic planning, management control and operational control. Strategic planning deals with the long-term purposes, the establishment of the strategy and plans to implement (see the interference with the planning function in this case). Management control deals with obtaining and using resources in an efficient and effective manner for achieving the organisation's goals and is based on the accounting and financial assessment of performance. However, operational control processes are contextualized and tend to be

based on the non-financial measurement of performance.

According to Merchant and Otley (2006), Anthony's terminology and delimitations (that have dominated the

research field and the university education regarding the management control for decades) have encouraged the focus on the financial and accounting dimension.

Figure 1. Typology of control



Source: graphic adaptation after *Encyclopedia of management*, 2006, p. 490.

Therefore, in organisations nowadays, control should not be reduced to financial and accounting control. The *Encyclopedia of Management* (2006, p. 490) could be an argument to this purpose, describing the control as being represented by the means through which the actions of individuals and groups are focused towards achieving the organisation's goals, to the detriment of other possible actions, and the management function of control implies two distinct approaches: regulatory control and normative control, as shown in **Figure 1**. One can easily see the place of financial and accounting control and its relation with the whole, which even includes the establishment of performance standards. More recent approaches on management control are other arguments for not limiting control to the financial-accounting area. Thus, Merchant (1982) distinguishes various forms/dimensions of management control depending on the scope of control: specific actions, results, staff. It is obvious, for instance, that when talking of staff control (undertaken by improving communication, coordination, by encouraging mutual or group control, among others), we lose the link with the financial and accounting control.

Simons (1995) thinks that managers can exert control by means of four levers:

- Belief systems represent the basic values that can provide inspiration and a certain guidance for the organisation. They are introduced by vision, mission, credo, fundamental objectives. The value system of an organisation should not be a declarative, artificial construction, but it should be known, accepted and respected by subordinates and managers, so as to become an effective lever of control;
- Limitation systems state the behaviours and activities that are not allowed (tools introducing them are codes of conduct, ethics, internal rules, but they can also include certain strategic limitations, i.e. forbidding certain market opportunities that might damage the organisation). Though prescriptive, the negative/restrictive control – through its systems of limitations (constraints) - may allow managers to delegate and ensure the conditions for additional flexibility and creativity. In order to explain this more clearly, Simons metaphorically associates the

limitation system with the brakes of a vehicle, in whose absence cars cannot operate at maximum speed. Likewise, Simons considers that the belief systems and the constraint systems are like yin and yang, and jointly create a “dynamic tension” between commitment and sanction, i.e. they “establish direction, motivate and inspire, and protect against potentially damaging opportunistic behaviour”;

- Diagnostic control systems aim the efficient use of resources and are specific to traditional control (they are obsolete for the current economic conditions and they should be completed by the other systems described). The tools of diagnostic control are: budgets, plans, financial and accounting systems;
- Interactive control systems provide feedback on the strategy, respectively they help focus information on strategic uncertainties and they help the organisation comply with the changes in its external environment. Specific tools are the studies on competition, the market studies, etc.

Hewege’s approach (2012) may be an interesting perspective on this question. He considers that three distinct periods of evolution in management control theory can be identified: the age of classical management (with Taylor and Weber as the most important representatives); the age of modern control, dominated by accounting (initiated by the works of Anthony); the post-accounting age (major representatives: Kaplan, Merchant, Otley, Ouchi, Simons, Whitley). More recent approaches (Berry, Cullen and Seal, 2005) extend the control area outside the organisation, dealing with value chain control (where financial control is, again, only a part).

For **the sixth question**, a context where we get very close to what organisational control means, the logical answer would be: control should be held by shareholders, but practice is most often crushing. The existence of works on this topic is not accidental; people talk more and more about the fact that “a manager who does not own the property is more focused on his/her own personal interests, not those of shareholders” (Fülöp, 2012, p. 15). As of 1983 – with the publication of Henry Mintzberg’s *Power in and around organizations* – both theory and regulations act to solve this conflict of interest by clarifying the control position held by each (Ben Taleb Sfar, 2014; Gomez, 2009). Thus, the solution that has been identified and promoted is found in the field of governance and/or corporate responsibility; it

does not imply that one or other part has more or less power, but that control is given by the formula where any major centre of power (shareholding, the supervisory board, the managing board) cannot do much without the involvement of the others. In other words, irrespective of proportions, organisational control should be divided so as to ensure a proper ethical operation of the referenced entity. About the same can be said on a country’s leadership: the separation of powers – only the judicious and clear distribution of responsibilities and rights (Dobrotă et al., 2011, p. 12) – may ensure reasonable integrated control, based on which any democratic state exists and operates, avoiding the concentration of decisions at a single level/pool of power. On this basis, we may talk of control as domination achieved by complementarity and interdependence, a new desirable paradigm of action, where a company/entity is governed in a transparent and participative manner, resulting in enhanced synergy, but the result depends on the management’s capacity of motivating the employees/stakeholders to act like the owners of the entity. In the same sense, the success of any entity/company largely depends on goods relations with the stakeholders; otherwise, egocentrism would ruin everything.

Following more or less the same parameters, Vosselman and van der Meer-Koistra (2009) analyse the relationship between control and trust (and accounting, but we shall only hold the elements on the relation between the first two). Thus, the two authors distinguish between traditional control and relational control, specific to new organisational constructs. While traditional control implies a centre where power is located, concerned with the results of the behaviours of the other parties, in the case of relational control no group feels the need to control the others, but just the need to voluntarily send and receive signals of involvement, commitment from the other parties of organisational systems.

When talking of possible changes in paradigm, we should also emphasize Hofstede’s opinions (1978). Thus, he thinks that the cybernetic view, which dominated the management control approach for a long time, as we underlined, is suitable for technical systems, but organisational (even management) control for any honest entity is a social process, probable in a social and technical system, and there are many situations where standards cannot be established, results cannot

be measured exactly and the informative feedback has a doubtfully utility ratio.

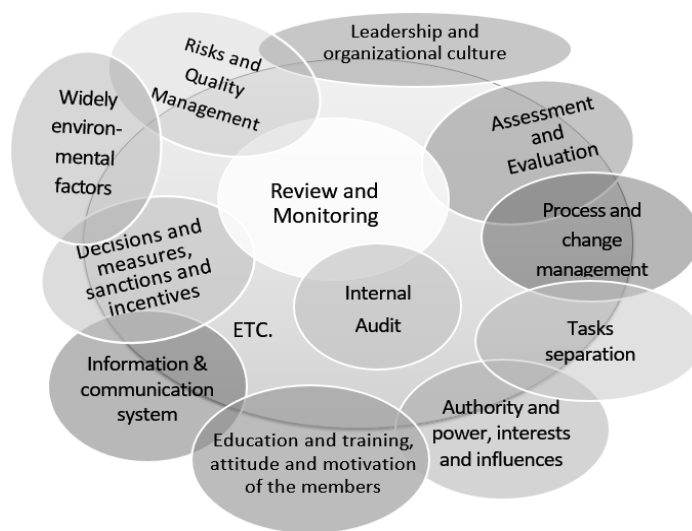
A first alternative proposed by Hofstede is the homeostatic optics. This is close to the cybernetic view, but "without the division labour between controlling and controlled units". However, in organisations we can also find cases where the requirements of a cybernetic model, even converted into a homeostatic one, cannot be met. In such cases, Hofstede talks of a political control, exercised by a controlling structure that considers the positions of power of the various parties involved. "Control games" between the various actors will unfold in this structure.

As we are getting close to the end, it may be worth to repeat: control has the purpose to limit the possibilities of subjective, illegal and immoral "manoeuvre" – coercion for the stakeholders, so as to underline that the reasonable freedom of citizens and the intimacy of individuals should not be ignored. Moreover, limiting individual creativity, in our opinion, is an extremely serious issue, with harmful effects, especially in the long term. Thus, problems arise regarding control performance compared to its obvious automatic mechanisms. If people end by acting like robots, the situation can only be seen as risky; the opposite would be the normal thing to do. Even when staff recruitment and training problems appear, the result/behaviour may be easily classified as a control habit. Unfortunately, in order to declare that the control they have created and

implemented is interesting, organisations are rather focused on finding a rational appearance for their irrational actions, than on ensuring an involving harmony. In this context, we consider that control should mean a state of balance and mutual respect, a genuinely desirable social relation between the one who holds the power and the others. There are many things to do in this field, up to cultural aspects, so that the attribute of power control manifests equally, with the same attribute of all stakeholders. Otherwise, how could a relationship in the field of partnership approaches be established? Why not begin with a better definition of what is control seen from as many perspectives as possible, namely from the viewpoint of all the actors; this will surely result in an enhanced general voluntary compliance (see imbalances at the level of actual tax control, while the formal-normative framework seems to be perfect).

From our point of view, control is an extremely wide concept, including part of the design, performance and operation of systems in a certain way. Besides review, monitoring and auditing, the content of control also includes a wide range of component, such as: the leaders' philosophy, charisma and attitude, organizational culture, the employees' education and training degree combined with their morality and attitude etc. Inter alia, managers control their unit through decisions and personal example, by how they solve problems and conflicts, by how they assign rewards and sanctions etc.

Figure 2. A profile on the content of control



Source: the authors

Finally, since the complexity and ambiguities of any entity require extremely structured approaches and a capacity of approach from various perspectives, we find that the notion of control can only be defined in a holistic context. Thus, we propose a profile of control as illustrated in **Figure 2**. As it can be seen, we have outlined the content of control as closer to truth/reality, in our opinion. Initially we attempted a representation based on lines and square angles for **Figure 2**, but much too clear separable volumes/rectangles resulted and we thought that it was a less holistic style. Even though we were based on rectangles, and the reference representation uses cubes, this does not mean that the last one is less suggestive. On the contrary, especially when one wants a representation that is more than tridimensional, that briefly includes the components and objectives of control along with its means and characteristics, no other form, more synthetic and comprehensive than the COSO cube, has been identified so far. Reducing the level of synthesis, we just outline some aspects: the content and the concise objective of control. Therefore, we have used various circles and ellipses, considering that the irregular shapes are closer to what we aim at stating, but we are still only close to the truth. It is clear that, due to the use of irregular and inconsistent shapes from one case to another, depending on the specific features of a single unit, the representation could be closer to individual truth, but generalisation has its sacrifices.

CONCLUSIONS

Summarizing, **Figure 2** should suggest the content of control, “a complex organisational phenomenon” or an undulating conglomerate implying the integration of:

- Specific and clear organisation, as a part of the architecture and resistance structure of the entire entity;
- Elements (fully found in the content of control as domination, unlike others, that are only found partially):
 - Review,
 - Assessment and follow-up of the results, as well as
 - Audit, all based on precise enough metric systems;
- A distributed exercise of power compared to the separation of tasks, influence and interests; information and communication; mutual learning, counselling and advice; leadership and corporate culture; correlated systems and convergent processes; competent resources and quality sources; the preparation, behaviour and attitude of stakeholders, to create the required environment for the proper operation of the referenced entity.

The proposed definition might be considered much too extended, even tending towards a control framework, so that we briefly restate it: control is the harmonious integration obtained through the organisation providing the required rigour for the exercise of influences, interests and reviews so as to achieve the envisaged results.

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The importance of professional judgement applied in the context of the International Financial Reporting Standards

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Abstract

Guidance has always been welcome in terms of applying professional judgement in the context of the principles-based accounting standards – International Financial Reporting Standards. This fact is the result of the complexity and diversity of some situations, which might give rise to difficulties in terms of choosing the appropriate accounting policies and methods (depreciation, inventory valuation on hand at the end of an accounting period, the recognition of revenues and expenses from a construction contract, accounting for lease contracts by the proper determination of the type of lease: financing or operating), and respectively the need to verify if the criteria set by the principles-based accounting standards are met. This “freedom” of choice and disclosure might create problems in terms of accounting information quality. The possibility to select accounting methods based on the Standards’ provisions is meant to generate a true and fair view of the company’s financial position and financial performance.

In these cases it is recommended to use professional judgement in order to reach a conclusion which is in accordance with the accounting principles and is not enforced by any accounting rules, since the exercise of individual professional judgement is preferred against the “pure” compliance with prescriptive legal requirements.

Keywords: Professional judgement, principle-based accounting, true and fair view, disclosures, financial reporting, lease accounting.

JEL Classification: M41.

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Introduction

Professional judgment is defined as the application of the accumulated knowledge and experience gained through a relevant accounting or auditing training, by making use of the ethical standards, resulting in making informed decisions about the courses of action that are appropriate in specific circumstances, such as an audit mission and/or the accounting of economic transactions, by observing accounting principles.

The present paper aims to analyse the impact of professional judgement and the role it plays in the preparation of financial statements. We also intend to emphasize the difficulties which arise from the use of professional judgement, in the context of the application of the International Financial Reporting Standards (IAS/IFRS).

Company managers want to present in the financial statements a favourable image of the company's economic reality, while complying with all the accounting principles as stated in the accounting standards (Belkaoui, 2004). A fundamental part of this objective is the engagement of individuals with sufficient knowledge and experience in the process, since they are able to apply the relevant skills and knowledge in order to identify all the reasonable alternatives (Berheci, 2010; Girbină and Bunea, 2008). Therefore, a detailed consideration of information that may seem contradictory and might lead to an erroneous solution is needed, as the key to a proper and consistent application of professional judgement (Feleagă and Feleagă, 2007).

The research methodology used in this paper is a fundamental one, consisting of the analysis of data and previous research results collected from the literature. The purpose of the analysis is to verify the assumption according to which most financial information is processed by making use of the professional judgement. In addition, we have also used a questionnaire in order to verify the auditors' perception about the use of professional judgement in their daily auditing activities.

Another objective of the research is the identification of difficulties in applying professional judgement in the context of IFRS. The desired result of exercising professional judgment is the accounting of financial operations with the observance of accounting principles, by choosing accounting options that lead to the presentation of the economic substance of the items, events and transactions.

1. Applying professional judgment

The judgments made by accounting professionals might be challenged because of the nature of their professional responsibilities and the flexibility of the existing regulatory environment. Different conclusions can be reached in applying the IAS/IFRS, even in similar circumstances, which does not necessarily mean that one conclusion is right and the other is wrong (Ionescu, 2011).

When the professional judgment is challenged, a proper documentation of the used procedures is required, which can show the analysis of the facts, circumstances, and alternatives considered as a basis for conclusions.

Therefore, when the professional judgment process is appropriately applied and documented, it is much easier to support and defend the conclusions. The higher the degree of complexity of a certain problem is, the higher the necessary degree of documentation.

It is obvious that the decisions or conclusions, which are not supported by the facts, evidence, or other documents do not constitute a reliable source. Well-reasoned and well-documented professional judgments is always respected in the case of internal practice reviews and defended in external inspections or other situations, because it emphasises a constructive effort aimed at an adequate reflection of the company's economic reality.

A way to avoid the discrepancies that result by attempting to distort the economic reality is to satisfy the need of unity. This can be achieved by grasping the concept of the primary objective of an economic entity: the maximization of its benefits. There are numerous solutions that are meant to lift any barrier, especially in the case of stringent regulations.

The current concern in the field of accounting regulations is to avoid the subjectivism as much as possible, in order to reflect and provide reliable and transparent information, by making appropriate use of the professional judgement.

Regulation can improve the fundamental principles of the accounting theory, by pointing out what the accounting "should be" (Feleagă, 1996). Accounting regulation has the following objectives:

- To ensure the regulation of accounting policies and to determine ways to improve the accounting, in general terms;

- To allow the users of financial statements to make reasonable decisions based on the provided financial information;
- To create a climate of trust between the owners of capital and the business managers;
- To serve as a “referee” between the parties of the economic life, especially the accounting information providers and the auditors who certify its quality, thus ensuring its reliability.

In this context, there is an obvious need for a thorough analysis of the accounting principles and policies used by an entity, and for an acknowledgement of the advantages of transition from the rules-based accounting to a principles-based accounting, from the concept of the maximum amount of information to the concept of the minimum required information (without a prescribed format for the financial statements), established by the appropriate use of professional judgement.

1.1. Methods of documentation

It is very important to properly document a conclusion, by performing a consistent analysis of the identified problem, the applicable accounting standards, the evidence obtained so far and the alternatives that can be considered within the boundaries of accounting principles.

The applicable questions are:

- Did we properly present the rationale for the chosen alternative by pointing out all the applicable facts that constitute the obtained evidence, including the reason why other alternatives do not adequately reflect the economic and accounting substance?
- Are the time and effort spent in the process and the extent of documentation consistent with the significance and complexity of the results obtained by applying professional judgement in a consistent way?

1.2. Identifying the issue

In this stage it is necessary to act using professional judgment and to consider the following:

- Have we identified and stated the issue appropriately? A proper identification prevents poor performance.

- Are there any other issues that need to be considered in this process? All the related issues can have an impact upon the result and may influence the way professional judgement is applied.

The professional judgement is applicable in a certain context, once there has been obtained a thorough understanding of the relevant facts and all the information is available concerning the transaction, event, or situation. It is certain that the level of performance increases at the same time with the level of knowledge.

The selection of accounting policy and estimation techniques is made with the purpose of presenting information useful and relevant for users, which are in line with the company’s specific activities. IAS/IFRS also place particular emphasis on the need to take into account qualitative characteristics of financial information and the use of professional judgment when preparing the financial statements.

IAS 1 *Presentation of financial statements* requires the companies which prepare the financial statements in accordance with IAS/IFRS to present in the notes to financial statements an organized and systematic description of the applied accounting policies, as well as any exceptions from those policies, through reflecting the results of choosing a certain policy instead of another. Comparative information is also required in the case of changes in accounting policies. The question arises as to how these policies should be selected and it is required to provide a detailed disclosure of the nature, reasons and impact in the case of a possible departure from the stipulated accounting standards.

Furthermore, a change in accounting policy should only be made if the change is required by IAS/IFRS, or it will result in the financial statements providing reliable and more relevant financial information, by providing a comparative preview of the information obtained if the change did not occur in the first place.

1.3. Examples of applying professional judgement

Accounting and fiscal amortization/depreciation

The professional judgement is recommended to be applied, for example, when determining the depreciation method and/or the useful life of long-term assets.

In the case of a pig farm there is a concern for the increase of the production and reproduction performances of pigs. Therefore, the recommended useful life of these assets should be the period within which the purpose of the assets is fulfilled (usually two years and a half, maximum three years). This useful life differs from the one set by the Fiscal Code for this class of assets (four years), which is considered for the purpose of determining the tax on profit.

Therefore, there is a need to reflect the accounting depreciation and the fiscal depreciation separately. It is not accepted to use the useful life set by the Fiscal Code for both the fiscal and accounting depreciation.

The consequences for using a misstated useful life would influence the net book value of an asset and at the moment the sale of the pigs takes place, the net realizable value is much smaller than the net book value, resulting in a higher loss, not consistent with the economic substance of those assets.

Construction contracts

Another case which involves the use of professional judgement is represented by construction contracts, which are accounted for using the guidelines set by IAS 11 *Construction Contracts*. The applicable question is if the results should be accounted for at the end of the contract, or along each stage from the construction process.

The answer has been formulated by using one of the two alternatives: applying the prudence/conservatism principle (scepticism with regard to the way profit is obtained from a contract, meaning that the expected profit can be measured once the contract is concluded) or the matching principle.

The percentage of completion method of accounting is used in connection with the professional judgement in order to determine and account for the outcome of a construction contract, which should be estimated reliably, by recognizing revenues and costs in proportion to the stage of completion of contract activity. The effect of professional judgement in this case is that the expected benefits are determined in the same manner, by using the percent of expenses incurred per total estimated costs, or a physical measurement of the completed activities.

The alternative method (end-of-contract method) limits the measurement of revenues to the amount of

expenses incurred which can be recovered from the beneficiary. Since no profit can be recognized until the contract is completed, professional judgement acts as a mediator between accounting prudence and optimism, in case the benefits from the contract cannot be estimated reliably.

Lease contracts

Lease accounting (applicable standard IAS 17 *Leases*) is another example of how professional judgement is used and it calls into question ethical issues related to the exercise of financial reporting options.

In order to apply the appropriate accounting treatment, a lease must be classified in one of two categories: operating leases or financial leases. In the case of the financial lease, the lessee, benefiting from most economic benefits provided by the asset and bearing most of the risks, controls the asset and must report it in its financial statements, although he is not the owner. For operating leases, payments made by the lessee are reflected as a decrease in profits (expense) in each period.

Incorrect classification of a financial lease as an operating lease causes the understatement of the lessee's assets and liabilities, affecting financial analysis indicators. Presentation of operating expenses and financial expenses is also distorted. Such a wrong classification also affects the lessor's financial statements, but not to the same extent as the lessee's (the structure of assets, operating result and financial result).

The exercise of professional judgement is needed to determine what are the main risks and benefits associated with a lease contract, which involves a detailed analysis of the contract provisions and of the economic reality of the parties involved.

The essence of lease accounting is found in its emphasis on the economic substance of the lease agreement as opposed to the strict legal form of the agreement. To the extent that the lease contract transfers substantially all the benefits and risks economically consistent with outright ownership of the asset to the lessee, the lessee shall account for the transaction as the acquisition of an asset and the incurrence of a liability. This is called a capital lease (finance lease). Alternatively, if the substantial benefits and risks of ownership are not conveyed to the lessee in

the lease contract, the lessee shall account for the transaction as a rental (charge to expense the rental payment each period) and no asset or liability related to the lease would appear on the balance sheet of the lessee, which represents an operating lease.

Professional judgement is applied in connection to the “substance over form” principle related to the above mentioned matters.

Accounting measurement

The professional judgement is also applied in the context of defining the term “value” or for determining the value of an accounting item, which can have multiple meanings: replacement value, net realizable value, recoverable value, fair value, etc., depending on the nature of transaction and the element which is going to be measured; input value, output value, inventory value, depending on the moment when the measurement is performed etc.

One of the most complicated issues associated with accounting measurement is related to the selection of the measurement basis for the elements of the financial statements, so as to ensure credibility and relevance to the information provided. In accounting theory and practice there have been proposed several measurement bases (historical cost, current cost, realizable value, present value, fair value). In order to determine the suitable measurement method for each element of the financial statements, an assessment of the advantages and disadvantages of each alternative is imperative by making use of professional judgement.

On the one hand, standard-setters have concluded that the most appropriate measurement basis is historical cost, due to the advantage given by its reliability, clarity of definition, and verifiability. However, historical cost accounting does not anticipate all of the entity’s profits, because the conservatism/prudence principle does not allow the recognition of the potential gains related to assets, but only that of potential losses. On the other hand, historical cost measurement has its disadvantages, because in a market economy there are price fluctuations, and it is impossible to obtain a correct result in accounting by using a historical cost measurement system.

In many cases, intention is what determines how items are measured, recognized or disclosed in the financial statements. Intent is an element that requires the use of

professional judgment in situations such as: establishing the depreciation/amortization method or the useful life of tangible or intangible assets according to the entity’s intention regarding the use of the asset; selecting the method used to measure inventories at the de-recognition date (first-in-first out or weighted average cost) depending on the entity’s intention regarding the order in which inventories will be derecognized; computing the present value to determine the recoverable value depending on the entity’s intent regarding the use of an asset, etc. Also, setting the input value of an asset, by taking into account the price of purchase as stated on the invoice, plus incidental expenses is based on professional judgment, since the latter must be justified by the criteria of capitalization (result in bringing the asset into its state of operation or use).

The exercise of professional judgment is associated with the freedom of choice regarding the concepts and with the use of options related to accounting policies. The rule limits, while the principle encourages the exercise of professional judgment. The main objective is to obtain reliable information, but because the economic reality is that we have to face the new era of globalization, the limitations of national rules are disclosed by the contrast with the concepts promoted and supported by international standards. The latter stand out due to the freedom offered by the appeal to principles instead of rules, by promoting the exercise of professional judgment and the reliability granted to the standard-setter.

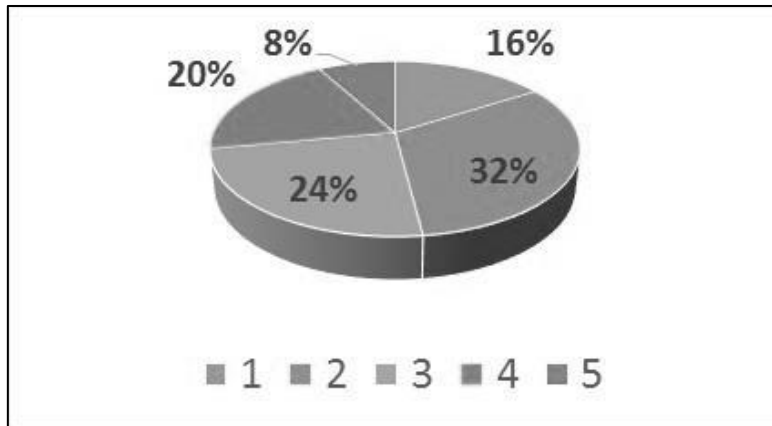
2. The importance of professional judgement

In order to demonstrate the importance of professional judgement, we have distributed a questionnaire to a sample of professional auditors, which determines their position regarding the use of professional judgement. The respondents completed and returned 25 surveys, based on which we performed an analysis of results using a scale from 1 to 5 (1 – totally disagree, 2 – disagree, 3 – neither agree nor disagree, 4 – agree, 5 – totally agree). The primary purpose of the study was to determine the degree of importance associated with the professional judgement.

The questions based on which the results were analysed, the results and the analysis of results are presented in the following paragraphs.

Q1. Does the participation to continuing professional development courses have a contribution to the enhancement of professional judgement?

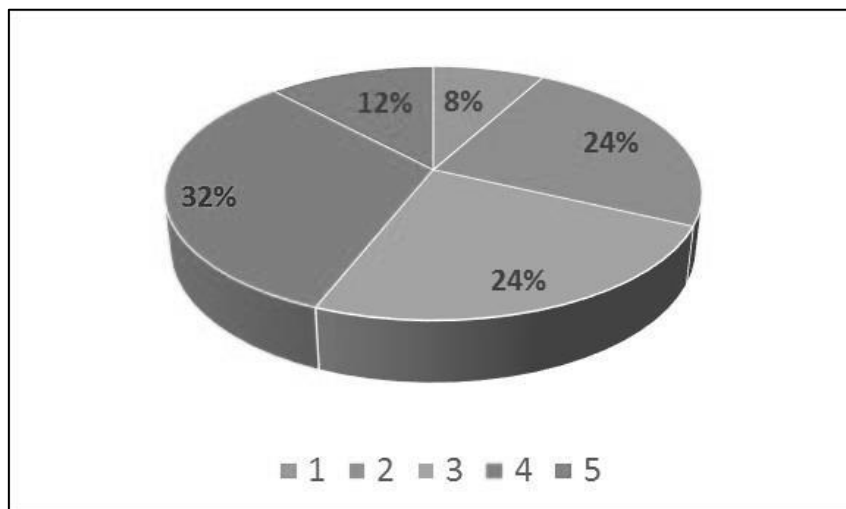
Figure 1. Professional development courses and professional judgement



Source: author's processing based on the answers provided by the questioned auditors

Q2. Does the consistent application of professional judgement contribute to the true and fair view of the financial position and the performance of an entity?

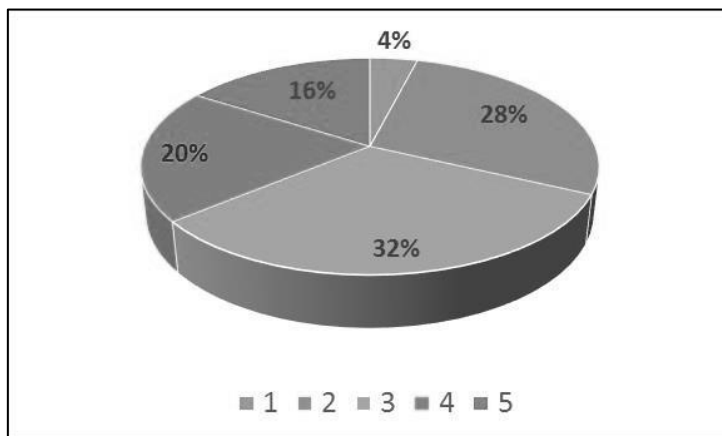
Figure 2. Professional judgement and the true and fair view



Source: author's processing based on the answers provided by the questioned auditors

Q3. Does the application of professional judgement lead to a development of creative accounting techniques and practices?

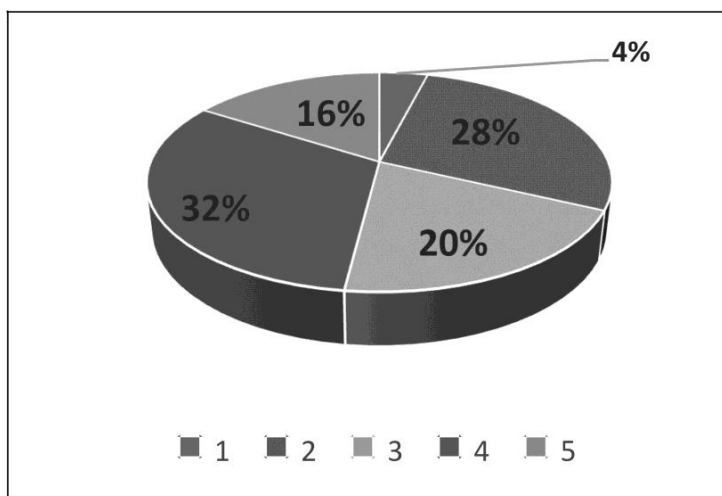
Figure 3. Professional judgement and creative accounting



Source: author's processing based on the answers provided by the questioned auditors

Q4. Do the financial statements prepared based on the IAS/IFRS better meet the users' informational needs as compared to the ones prepared based on the rules established by the national accounting standards?

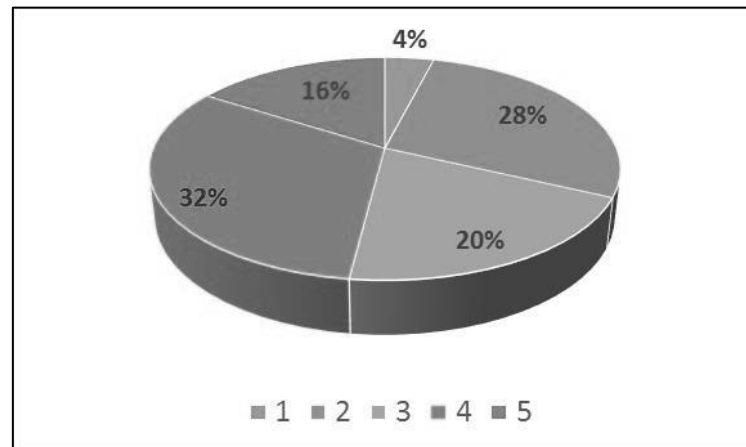
Figure 4. The extent to which the financial statements prepared in accordance with IAS/IFRS better meet the users' informational needs as compared to the financial statements based on national regulations



Source: author's processing based on the answers provided by the questioned auditors

Q5. Does better and more frequently used professional judgement come with greater professional experience?

Figure 5. Professional experience and professional judgement



Source: author's processing based on the answers provided by the questioned auditors

From the answers received from the respondents, most of the auditors believe that the professional judgement plays a very significant role in the reflection of a true and fair view of the company's financial position and financial performance.

52% of the questioned auditors believe that the participation to continuing professional development courses has a contribution to the enhancement of professional judgement, while the remaining 48% sustains that the real case scenarios bring added value. However, other studies (Salter and Niswander, 1995; Frecka, 2008) have demonstrated that the knowledge acquired in the course of university and post-university training, as well as professional development courses organized by companies contribute to the development of professional judgement.

44% of the interviewed auditors believe that the proper application of professional judgement leads to better results in the financial reporting process, while 24% are reluctant due to the subjectivity involved in making a choice and the chances of making the wrong decision.

46% of the subjects agree that professional judgement can lead to the development of creative accounting techniques. This development might have a positive impact, since it can contribute to building proper measures to manage resources in order to achieve performance.

48% of the questioned auditors agree with the fact that the financial statements prepared in accordance with IFRS meet better the information requests of the users of financial statements than the financial statements prepared in accordance with the local generally accepted accounting rules.

Also, most of the study subjects agree with the fact that with greater professional exposure and experience, comes greater professional judgement.

In exercising professional judgment, it is recommended to rely on the accounting policies and treatments stipulated by the national and international accounting regulations, reflecting consistency in the application of accounting options.

Conclusions

The prospect of a reality specific to the economic entity is built on the professional judgment applied both in accounting, to assess how the financial statements are prepared, but also during an audit mission, because the auditor's professional judgment is vital, helping him evaluate the audit evidence collected, in order to be able to justify and support his opinion on the audited financial statements.

Classifying and reporting certain transactions, events or amounts in the financial statements, which result from

complex, dynamic and not clearly defined situations, especially if standards are incomplete, requires a “sound application” of the professional judgement, which best proves its usefulness in these type of situations.

Another characteristic of the nature of professional judgement is associated with the financial consequences of an improper application, such as the case in which the economic substance of a reported transaction or event is disregarded for the benefit of its legal form – leases.

Professional judgement is closely connected with the reliability offered to the users of financial statements, since their decisions are based on the values reported by the preparers of financial statements. The objective is to present information as a result of an adequate analysis, through the application of measurement and classification methods and techniques suitable to each specific entity.

Professional judgement is a key skill for preparers, both auditors and accountants of financial statements, especially under a principles-based accounting regime. However, making a judgement can be difficult and there is not necessarily one correct answer. Being able to make good judgements is the essence of each profession, in general. For example, in the case of an

accountant; the benefit is associated with a high quality financial reporting, once all the transactions of the company have been properly accounted for.

Professional judgement applied in the audit brings added-value by a proper identification of the audit risks and the development of audit procedures, as well as a certain determination of the workload and the evidence required to sustain the audit opinion.

Both professional scepticism and objectivity are essential to the process and to reaching an appropriate conclusion. Professional judgment is not an arbitrary decision, a substitute for professional scepticism, or a method to rationalize a particular result. Performing the process in “form” without focusing on the substance does not constitute well-reasoned professional judgment.

It is important to highlight the role of trust in a principles-based accounting framework. The quality and integrity of the judgements made give rise to correct numbers being reflected in the financial statements and, therefore the trust in the operation of principles-based accounting standards increases once more if the suitable methods of valuation and classification are applied consistently.

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Study regarding the creative accounting techniques in management accounting

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Abstract

Once implemented, a managerial accounting system will also attract the manifestation of creative accounting phenomena, especially in times of crisis and fiscal pressure. Having a more relevant set of information at their disposal, managers are tempted to employ more or less ingenious, questionable or legal techniques, in order to improve the presentation of the financial statements. In the current Romanian economic context, a direct link may be observed between the creative accounting practices, the incompetence of managers, the decline in activity, the crisis periods and the fiscal optimizations. A national emphasis is placed on the use of creative accounting in order to mislead the users of the financial statements. The study of the Romanian managerial accounting system is characterized by a relatively small number of field research studies, especially with regard to organization and implementation. In fact, our research intends to warn about the major challenges in the perceived benefits of organizing a modern system of management accounting in the Romanian context. Although management accounting has evolved continuously during recent decades, its progress depends highly on the extent to which the academia and managers will be able to improve various methods and the effectiveness of decision processes. Implementation difficulties should be identified in a manner that is much clearer and without neglecting the social and behavioural implications. Emphasis should be placed on the central role of the behavioural issues in managerial accounting.

Keywords: Managerial accounting, creative accounting, production cost, change in managerial accounting, altering costs, removal from stock.

JEL Classification: M41.

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Introduction

Managerial behaviour is able to affect the practices of the managerial accounting systems, which is mostly visible at the national level. Managerial decisions are able to determine the shaping of the accounting information, according to a specific set of objectives. The managerial strategy which is erroneously focused on the short-term (and the very short-term) leads to mutations in the production of accounting information. The tendency to invent and use creative accounting techniques (on the nefarious side of the phenomenon) becomes a mandatory concern of Romanian managers, raised to the level of common practice. A manager's perception of the accounting system as a whole generally comes down to the idea that anything is possible, and the consequences can be easily minimized. Finally, the cash flow route dictates over the shape of the accounting information and also over the performance level.

Managerial accounting has a rich history, closely related to the changes in organizational strategy. After World War I, the advances in managerial accounting actually happened only in terms of an increase in the external financial reporting. For over 70 years, managerial accounting is subject to the requirements of the financial reporting. The managerial accounting reform should be based on the idea of a development process which is highly independent, but at the same time, closely related to the strategic management of the organization.

Managerial accounting systems must revolve around the principle that a product, by means of all its attributes, rather provides value to the customer, than to its manufacturer. Managerial accounting remained isolated from the other functions of the organization for too long. Classical methods have practically diseased organizations by means of excessive and rigid structures, acting in dynamic economic environments.

Managerial accounting, through its classic methods, leads the organization to the wrong direction, rewards managers for business failure and provides no incentive for the actual performance (Kaplan, 1988). The accounting professional is stuck in the trap of the innovations made in the field of management accounting 60, 80 and even 100 years ago (Kaplan, 1986).

The traditional methods of cost calculation become obsolete. The loss of relevance in the case of traditional cost calculation systems is mainly due to the existence

of a gap between the current model of organizational control and the analysis centres model, as well as the difference between the structure of the actual cost and the image thereof, as provided by the managerial accounting. The perspective over the company that was the foundation of the analysis centres method no longer corresponds to today's reality.

The capital may have alternative uses, so managers should be concerned if the return on capital exceeds the cost of capital, which can be measured by means of the profitability generated by alternative uses. The second reason for measuring the return on capital is the promotion of control and analysis in the organization of capital budgeting. In the absence of some form of effective measurement of the actual return on capital in the process of investments budgeting, there may be a reduced incentive for managers to accurately estimate future cash flows.

The main mission of the managerial accounting was "to track the absolute truth", where "the absolute truth" was defined as achieving the most accurate value of the cost. But managerial accounting began to evolve, which fixed a large number of deficiencies, including the concern for determining a unique cost. The most important contribution was the focus on the potential benefits of making decisions based on accounting information. The idea of different costs for different purposes has spurred concerns to define a conditioned truth, or a decision model. Decision models occur when outsourcing information for various purposes (Horngrén, Foster and Datar, 1997).

The approach of our study captures a complex and delicate issue of contemporary management accounting systems, pursuing as objectives the motivational complex for the development of creative accounting techniques, and also the identification of some creative accounting techniques placed at the boundary between legality and fraud, including their impact on the quality of the accounting information.

The study's contributions are highlighted mostly at the applicative level, obviously due to the types of research conducted. One of the fundamental objectives of our study is to spark interest in the practical possibilities of "protection" from the dangers of creativity in a managerial accounting system.

The limitations of the study are generated by the characteristics of field research, recalling in this regard

the possible subjectivity of the researcher in the context of direct access to the research topic, as well as the smaller number of organizations that can be analysed in a certain period of time.

The importance of this study mainly aims at accounting professional and auditors, mostly through the perspective of reliability and reality of the information presented in the financial statements.

From a structural point of view, the next section depicts the state of knowledge in the field of creative accounting techniques specific to managerial accounting. The second section highlights the research methodology used in the study, followed by the presentation of the study results in the third section. The last section captures our findings and conclusions.

1. Literature review in the field of managerial accounting

International literature is replete with descriptions explaining the multitude of approaches and models that can be used in an effective managerial accounting system. Most studies present the idea of experiencing a prolonged crisis of the managerial accounting, exceeded by the transformations in the organization's internal and external environment. They also reveal numerous ways of reforming managerial accounting, by practices and techniques able to support organizational changes.

Empirical studies conducted by specialists, particularly in the UK, USA, Japan and France, discuss transitions in management accounting from many countries. These studies attempt to explain the implications of the recent technological developments, organizational and management procedures on management accounting systems.

The state of knowledge at international level provides a detailed overview of the latest techniques. The studies assess the need to use these techniques, the weaknesses and strengths of each technique in the current organizational and economic context, as well as the ability to face future challenges. In fact, many of these techniques represent a breakthrough in the management of the organization.

Invariably, the most relevant works capture the current challenges of management accounting (Bromwich and Bhimani 1989, 1994; Bhimani and Bromwich, 1996; Armstrong, 1987; Albu and Albu, 2003a, 2003b; Aston,

Hopper and Scapens, 1995; Clemens 1991; Coates and Longden, 1989; Drucker, 1990; Johnson, 1992; Johnson and Kaplan, 1987; Kaplan, 1985, 1994; Scapens and Roberts, 1993; Woods, 1989; Drury, 2000; Horngren, Foster and dated 1997; Bromwich and Hopwood, 1986; Vámosi, 2000; Bartolomeo et al., 2000):

- Overtaking of the financial accounting objectives, by using arbitrary allocation methods, which do not reflect the reality of cost drivers inside a modern system of production, and hence the black accounting (or double record) syndrome, aimed to obtain reports that are useful for the adoption of certain decisions;
- Traditional cost assessment methods do not reflect the causal relations of resources consumption inside organizations that use modern production and supply technologies, distorting the value of production costs and profits. Managerial remuneration schemes stimulate wrong decisions as revealed by conventional techniques;
- Excessive focus on the existing cost systems and their inability to generate relevant and useful information in the decision making process;
- Empirical studies on using the ABC method confirm organizations' hesitation regarding the implementation of new managerial accounting systems;
- Maintaining the classic hypotheses on the concept of performance, as well as the excessive and exclusive focus on short-term objectives;
- Positioning managerial accounting in the organizational chain so that it can exercise a more important role;
- Monitoring and planning performance can be improved if non-financial indicators are used alongside financial ones. Some costs are difficult to define and measure, although there is a significant set of non-financial information available. The performance of just-in-time systems is measured, for example, in terms of elapsed time, distance travelled, degree of space occupancy, product complexity. Other examples are the dashboard and the balanced scorecard;
- Introduction of a strategic dimension in managerial accounting. An increasingly stronger need is stated to determine the costs associated with the

organization's strategy and monitoring the cost structure of competitors. Currently, costs of operations that add value in the customer's perspective (production flexibility, quality, delivery times, after-sales service) are invisible, hidden in the mass of overheads, and subsequently incurring arbitrary allocation. Strategic management accounting has the advantage of making those costs perceivable for the management of the organization;

- The adoption of techniques used in the context of other countries is generally problematic. However, some Japanese techniques have been successfully implemented by British companies (cost tables, target cost). Many organizations remain faithful to traditional methods. New techniques do not seem to elicit universal interest, and there are differences between organizations in the same geographical area regarding the risks assumed by the implementation of modern techniques. North American and UK studies reveal there is a pronounced openness towards progress where organization is informal and simple, which gives flexibility and adaptability to a dynamic environment.

National literature can be characterized only in recent years by a production of works that capture some topics of managerial accounting, including those close to our study, concerning the techniques of creative accounting (Malciu, 1999; Feleagă and Malciu, 2002; Ionașcu, 2003).

2. Research methodology

The privileged position in the study is taken by the experiment type research, which involved direct access to research subjects, as well as the case study type research, involving the analysis and interpretation of some existing features. In other words, a clinical or action-type research was employed. These belong to the field research family, their major advantage being the better perception of relationships and processes within an organization. Data collection and analysis were conducted from a total of 20 Romanian companies in the field of construction and civil engineering. The duration of the research and case study type experiment actually covered five financial years in the 2010-2015 timespan, involving the active participation on the part of the subject of the knowledge process. Experiments and case studies were built on real sources of information.

The field research mainly followed:

- Identification and possible solutions for the issues related to the implementation of a management accounting system, or to the change of an existing one (when applicable – if a management accounting system already existed within the company);
- Designing a management accounting system, by involving the entire organization in the process, and choosing an instrument which is suitable with the implementation environment;
- Perception and understanding of the change by the stakeholders;
- Deficiencies and reticence arising from the implementation process;
- Trends in the alteration or biasing of information produced by the implemented system.

Our research hypothesis was the fact that in the current Romanian economic context, a direct link may exist between creative accounting practices, incompetent managers, the decline in activity, periods of general economic difficulty and the urgent needs for fiscal optimization. It is actually what the British researcher Argenti mentioned in 1973. National emphasis is placed on using creative accounting in order to mislead the users of financial statements. Malo and Giot (cited by Malciu, 1999) stated that originally, creative accounting is a virtue, providing the accounting process with means to keep pace with the growing development of the markets and the proliferation of financial products. The major issue is caused by the rapid manifestation of the instinctive perversity of businessmen.

3. Research results

By analysing the creative accounting techniques or pseudo-techniques in the context of the undertaken field research, the following motivators were found:

- Costs arising from the conflict of interests.* Romanian managers are tempted to enforce the use of those techniques that reduce results in order to avoid fiscal pressure on income tax. Zimmerman's hypothesis that large firms bear political costs higher than small firms always checks.
- Managers' incompetence.* When companies do not perform, they use various creative accounting techniques in order to retain customers, trade credit

from suppliers, and to ensure the level of financial indicators requested by investors. In this situation, this type of behaviour suggests psychological implications such as the non-acceptance of failure and the delay of the financial collapse.

- c. *Uncertainty and risk.* Conditions manifested in a weakened economic environment is an undisputable factor of the widespread use of creative accounting policies, even to the level of fraud. Salustro and Lebrun (cited by Feleagă and Malciu, 2002) believe that times of crisis are trial tests for businesses. They impact company treasury and generate risks that accounting only translates in an imperfect manner. Consequently, managers are tempted to use more or less ingenious methods in order to improve the presentation of financial position and performance.
- d. *The variety of economic activities.* The industry in which the analysed set of companies operates is construction – civil and industrial engineering. Construction is a particularly complex and complicated activity, difficult to control, which allows a permanent adjustment of the results. Using creative accounting techniques in this field is sometimes very difficult to detect.
- e. *The weaknesses of the production cost concept.* Using production cost as a basis for measuring inventories and work-in-progress is always suspect. Most costing instruments are open to criticism. There is no accurately calculated production cost, each of its values representing only an opinion (Ionaşcu, 1997).
- f. *Insufficient national accounting rules on accounting and management control.*

Ionaşcu (2003) insists on the distinction between creative accounting and accounting fraud. Adapting accounting policies to the economic developments should not be confused with those techniques that more or less bypass the accounting rules. The border between creativity and illegality is sometimes difficult to establish. The unclear distinction is often maintained by the promoters and users of the negative side of creative accounting.

The identified creative accounting techniques can be considered as more or less sophisticated and questionable, some of the being situated placing it in the obscure area between creativity and illegality. They were found in management accounting systems implemented

in the companies analysed as part of the current research.

I. The technique of altering the costs of the production sold involves distorting the information regarding the value of the removals from stock in order to achieve a certain objective. The objective is achieved by means of certain income fluctuations induced by the amount used to record the removal from stock. This malicious alteration of the real values is very well disguised in the context of large scale projects, with a very complex cost structure and whose removal from stock records are, by default, as complex. The correction will be hidden in the removals from stock of the following periods.

II. The technique of simultaneously misleading the users of accounting information using production costs. The cost manipulation technique is derived from the technique of altering the production costs. The selected objectives depend on what is intended to present to some users of accounting information, and the objectives must be achieved simultaneously. These users require financial information to be delivered by the means of the financial statements and, therefore, there cannot be built a separate image for each user. Technically, manipulating the information on removal from stock of the production invoiced to the beneficiary is preferred, taking advantage of the certain projects' complexity, as well as the lack of intelligibility of technical information and the perpetuated deficiencies in the implemented management accounting system.

III. The syndrome of "gift" production costs. The Romanian economic environment is far from benefiting from the effects of fair competition. Actual production costs of a project do not take into account the costs of obtaining the contract. We are not referring to the visible costs involved by the process of conceiving a price offer and bidding on a project, but to the costs that remunerate the more or less legal efforts of intermediaries. These costs are visible in the accounting records but they are not linked to the income that should be generated normally. The "gift" costs will always be considered non-deductible, thus increasing the company's overall tax cost. Consequently, these costs are hidden and scattered across the projects for the obtaining of which they were incurred, or the projects which offer generous monthly profit margins. The accounting production cost is therefore heavily distorted, hiding the actual company performance.

IV. Transfer pricing manipulation technique. Transfer price is the price paid for a product or service provided by another company belonging to the same group. The analysed companies are generally not linked together by capital participations, with few exceptions. In fact, it can be considered that certain companies are linked by the main shareholder, a natural person. Limiting the transfer price produces effects both at the level of the companies within a group, and the affiliates. This technique is a variant of the “round trip” technique (capacity swaps or capacity purchase agreements), mentioned in literature by Pastré and Vigier (cited by Ionaşcu, 2003). The round trip technique involves the increase of turnover by product transactions between companies in the same field, without effective payments or exchange of products. In the cases studied in the context of the field research, the artificial increase of turnover was also a consequence of the amounts circulating between affiliated companies. Not only turnover becomes fictitious, but also the costs generated artificially in other companies.

V. The technique of manipulating the coefficient used to allocate overheads. In the context of implementing a management accounting system, the management of certain companies did not entirely agree with the determination of production costs based on the direct costing method. These companies have required the identification of overheads and their allocation to cost objects. The associated risks and disadvantages relate to the difficult identification of overheads, the sometimes unclear distinction between overheads and general administrative costs, as well as the conventional nature of allocation coefficients. Determination of the allocation coefficient is affected both by the more or less real value of overheads, and by the selected allocation base - the value of direct production costs. Or maybe it is this vulnerability of the allocation coefficient that led to the adoption and implementation of such a system. The used technique consists in stimulating certain slippages in the space between overheads and administrative expenses. In other words, the essence of this technique is to create the possibility to include or not to include certain expenses in the production cost, depending on certain objectives. Clearly, company performance and tax costs will vary from case to case. For this purpose, various simulations are carried out with different values of the allocation coefficient, which yield different images of the company's production cost and the one that is best suited a given time is chosen.

VI. The technique of intentionally erroneous accrual accounting. The company's performance can be manipulated by the technique known as the “strategic management of operating result” (Ionaşcu, 2003). The levers used are the calculated costs and revenues or those that do not generate cash flows, and the deferred expenses and revenues. Deferred revenues and expenses are recognized initially in the balance sheet, and will be fully transferred to the income statement, at a given time or gradually, over a certain period of time. The deferred revenues and expenses method conceals the actual performance using the fictitious application of the connection of costs to revenues principle. Production costs associated with construction contracts are recorded monthly in the account “332 Services in progress”. Production invoiced to the beneficiary is erroneously recorded in the account “472 Deferred income”, disguised in the form of an advance payment from the beneficiary, or under the pretext of the inability to accurately determine the stage of completion. In fact, experience shows that the stage of completion is still determined from time to time, usually when the income tax needs to be determined (coincidentally or not). The arguments conveyed refer to the fact that the result is difficult to measure on the basis of estimates regarding the stage of completion. In reality, the result is adjusted depending on the image that is intended to be supplied to different users using the removal from stock and the transfer of deferred income from the balance sheet to the income statement techniques.

VII. The technique of double accounting records of production costs. It is a fact that information on production costs does not reveal an actual performance, individually (for each cost object) or globally (for the company/project). Although this reality is accepted and even imposed by managers, they feel the need of an accurate image of projects' profitability. As a result, they will require the construction of a parallel system for determining and presenting costs, pushing the accounting professional into the trap of double accounting records, even if the accounting departments suffer from restrictions regarding the allocated human and time resources. The analyses were carried out outlined some of the grounds of using double accounting records:

- The gap between the moment when the products are obtained and the moment they are invoiced to the beneficiaries;

- Invoicing of expenses that represent production cost in a period other than that in which they were incurred;
- Invoicing of fictitious services, which are included in cost of production of certain projects;
- Including “gift” costs in the production cost of other projects;
- Using different techniques of earnings adjustment, such as altering costs, misleading the users of accounting information, settlement accounts, deferred income and expenses accounts;
- Forced inclusion of certain general administrative expenses in production costs;
- Use of services for which no contracts have been concluded and whose costs are invisible or absent from the income statement.

VIII. The parasite production costs method. The parasitizing method is already a model to make a fortune in Romania, successfully tested after 1990 and based on the principle “parasitize and bankrupt what you manage”. The method has enjoyed great success in the context of damaging the state-owned companies, but has extended to the private sector, with all the associated risks. This technique generates the bankruptcy of a company by hijacking contracts, inducing unreal production costs, moving income to other companies, using under or overvalued transfer prices. The most interesting is the way the contracts are carried out by a parasite company that collects revenues, and the costs are transferred to the parasitized company. In fact, projects are carried out using the production means of the parasitized company. This is also possible because of the absence of an effective managerial accounting system that would ensure transparency and the control of dubious transactions. A chaotic organization of accounting records can be added, along with the denial to provide information on production recipes, methods of calculating production costs, contracts with major trading partners, reports on services provided by suppliers or invoiced to beneficiaries.

IX. The paradox of production costs related to clone projects. Ideally, the implementation of identical projects by the same organization should engage about the same production efforts and generate the same revenue. The price offer, the project, budget, execution

schedules are identical. In reality, more or less justifiable differences were found in terms of production costs related to the cost of identical cost objects. Among the explanatory factors of variation in production costs there can be included: different geographic locations in which the projects are implemented; different timeframes and environmental conditions; use of different materials, equipment and services; logistical conditions; fluctuating acquisition costs depending on the supplier; different professional qualification levels of employees involved in the projects; different professional competences of project managers; different conditions of project management; quality of services provided by different subcontractors; different remuneration of direct productive staff; different materials and workmanship consumptions; different project execution timeframes.

X. The method of invisible costs and the need for dual accounting records. We consider this technique to be a questionable one, as it over exceeds the limits of accounting creativity in its positive sense. There are times when a company incurs (operating) expenses that are not certified by support documents. There are obvious fiscal reasons, such as avoiding the tax on non-deductible expenses or the tax on salaries. We identified situations where part of the salary remuneration is not declared, because the tax cost is particularly high (but this is not a justification); situations in which purchases of materials and equipment were made without support documents; situations in which certain services provided by third parties are paid without any contracts or invoices; cases in which the effort of those who facilitate certain transactions must be rewarded. From the manager’s point of view, all these expenses represent a production effort, even if this effort is not budgeted, nor invoiced to the beneficiary. They are considered invisible expenses, because they are not included in the income statement, but in the balance sheet. Their existence in the balance sheet is only temporary, because eventually everything will be charged to income statement (by drawing up fictional or real, but overstated acquisition or services contracts) or justified under the guise of dividends payments. From an accounting perspective, these costs usually are hidden using accounts such as “409 Advance payments to suppliers”, “461 Sundry debtors”, “542 Cash advances”. From our point of view, placing amounts in the accounts 461 and 542 is risky, these being two of the most popular accounts in the context of the various external checks and inspections. The accounting records of production costs will not

include these invisible costs, but the company's management believes that the situation is incomplete. Accordingly, the management will require an adjustment of costs in the accounting records and, hence, the double accounting records syndrome.

In order to exemplify the technique of altering the costs of the production sold, we present below the trial

balance of expenses (before calculating the income tax), the income trial balance and the situation of production costs for the month of September in the year N, for the M1 company. The objective is a tax-related one, namely to have a payable income tax of maximum 50,000 lei for the third quarter. All sources of information are real.

Table 1. Trial balance – expenses. September, N. Company M1

Account symbol	Account name	Current amounts		Total amounts	
		Debit	Credit	Debit	Credit
<i>Class 6 Expenses related to</i>					
602	Consumables	1,067,226.23	1,067,226.23	3,147,901.01	3,147,901.01
6021	Auxiliary materials	1,067,226.23	1,067,226.23	3,147,890.81	3,147,890.81
6028	Other consumables	0.00	0.00	10.20	10,20
603	Materials in the form of small inventory	3,202.48	3,202.48	39,902.46	39,902,46
604	Materials not stored	4,294.60	4,294.60	16,571.91	16,571,91
605	Electricity, heating and water	771.92	771.92	1,005.06	1,005,06
607	Goods for resale	118.40	118.40	27,509.83	27,509,83
611	Maintenance and repair expenses	60.00	60.00	11,988.12	11,988,12
612	Royalties and rental expenses	58,209.60	58,209.60	111,390.21	111,390,21
613	Insurance premiums	10,157.56	10,157.56	22,786.22	22,786,22
622	Commissions and fees	3,347.70	3,347.70	12,391.70	12,391,70
623	Entertaining, promotion and advertising	485.36	485.36	3,797.27	3,797,27
623.01	Entertaining. Invoice	218.81	218.81	1,864.81	1,864,81
623.02	Entertaining. Fiscal receipt	266.55	266.55	1,401.21	1,401,21
623.03	Promotion and advertising	0.00	0.00	531.25	531,25
624	Transport of goods and personnel	4,178.08	4,178.08	40,041.14	40,041,14
625	Travel	482.10	482.10	1,482.51	1,482,51
626	Postage and telecommunication	68.32	68.32	397.26	397,26
626.1	Postage	68.32	68.32	392.16	392,16
626.2	Telecommunication	0.00	0.00	5.10	5,10
627	Bank commissions and similar charges	2,025.68	2,025.68	56,354.74	56,354,74
628	Other third party services	2,233,186.94	2,233,186.94	5,410,754.29	5,410,754,29
635	Other taxes, duties and similar expenses	2,045.00	2,045.00	34,160.07	34,160,07
641	Salaries	14,702.00	14,702.00	133,349.00	133,349,00
615	Personnel training	0.00	0.00	400.00	400,00
645	Social security contributions	4,124.00	4,124.00	37,121.00	37,121,00
645.01	Company's contribution to social security	3,006.00	3,006.00	26,983.00	26,983,00
645.02	Company's contribution to unemployment fund	147.00	147.00	1,332.00	1,332,00
645.03	Company's contribution to health insurance	809.00	809.00	7,337.00	7,337,00
645.04	Company's contribution to medical leave of absence	125.00	125.00	1,134.00	1,134,00
645.09	Company's contribution to salaries guarantee fund	37.00	37.00	335.00	335,00
658	Other operating expenses	22,528.17	22,528.17	79,767.82	79,767,82
6581	Compensations, fines and penalties	817.13	817.13	24,845.60	24,845,60
6583	Net value of assets disposed of and other capital transactions	-83.06	-83.06	-83.06	-83,06

Account symbol	Account name	Current amounts		Total amounts	
		Debit	Credit	Debit	Credit
6588.01	Other operating expenses	872.80	872.80	7,664.66	7,664.66
6588.02	Other non-deductible operating expenses	20,921.30	20,921.30	47,340.62	47,340.62
6651	Foreign exchange losses	25.89	25.89	555.33	555.33
666	Interest expense	11,953.74	11,953.74	42,866.86	42,866.86
668	Other financial expenses	-129.00	-129.00	578.20	578.20
681	Depreciation and provisions; adjustments for impairment losses - operating expenses	20,598.95	20,598.95	80,575.62	80,575.62
6811	Depreciation of non-current assets	20,598.95	20,598.95	80,575.62	80,575.62
691	Income tax	0.00	0.00	31,845.00	31,845.00
	Total class 6	3.463.663,72	3.463.663,72	9.345.492,63	9.345.492,63

Source: Author's processing.

Account symbol	Account name	Current amounts		Total amounts	
		Debit	Credit	Debit	Credit
<i>Class 7- Revenue accounts</i>					
704	Services rendered	3,085,846.28	3,085,846.28	8,348,931.45	8,348,931.45
706	Rental and royalty income	9,000.00	9,000.00	9,000.00	9,000.00
707	Sale of goods purchased for resale	123.00	123.00	28,392.43	28,392.43
708	Revenues from sundry activities	22,083.32	22,083.32	32,707.96	32,707.96
712	Revenues associated with the cost of services in progress	3,376,244.13	3,376,244.13	9,009,925.21	9,009,925.21
722	Capitalised costs of tangible non-current assets	2,248.50	2,248.50	77,768.93	77,768.93
758	Other operating revenues	0.00	0.00	751.74	751.74
7588	Other operating revenues	0.00	0.00	751.74	751.74
7651	Foreign exchange gains	0.00	0.00	173.31	173.31
766	Interest income	208.64	208.64	256.99	256.99
	Total class 7	6.495.753,87	6.495,753.87	17,507,908.02	17,507,908.02

Source: Author's processing.

The initial situation and actual situation of determining the income tax for the third quarter of the year N is as follows:

Total revenues from the trial balance (class 7)	17,507,908.02
- Revenues associated with the cost of services in progress (total amounts)	- 9,009,925.21
- Debit Revenues associated with the cost of services in progress (D712)	- 6,825,347.56
+ Revenues associated with the cost of services in progress (C712)	+ 8,640,871.36
= Total revenues	= 10,313,506.61
- Total expenses (class 6)	- 9,345,492.63
= Result (121)	= 968,013.98
Non-deductible expenses:	
+ Income tax expenses (691)	+ 31,845.00
+ Other taxes, duties and similar expenses (635)	+ 295.87
+ Compensations, fines and penalties expenses (6581)	+ 458.00
+ Other operating expenses (6588.01)	+ 1.93
+ Other non-deductible operating expenses (6588.02)	+ 47,340.62
= Total non-deductible expenses	= 79,941.42
Taxable income	1,047,955.40
Income tax owed	167,673.00
Income tax recorded	31,845.00
Income tax to be recorded	135,828.00

In order to achieve the objective of maximum 50,000 lei tax profit for the third quarter, the reverse reasoning is performed:

Target income tax	maximum 50,000.00
Income tax owed	50,000 + 31,845 = 81,845.00
Taxable income	81,845 / 0.16 = 511,531.25
Income (121)	511,531.25 – 79,941.42 = 431,589.83
Total revenues	431,589.83 + 9,345,492.63 = 9,777,082.46
Revenues to be discarded	9,777,082.46 – 10,313,506.61 = 536,424.15

Table 3. Situation of production cost. September, N. Company M1

Account	Project										Location	Total account
	X2	X3	X5	X6	X7	X8	X9	X10	X11	X12		
602	533,082.36		6,810.69	204,612.31	48,139.59		123,965.48	107,601.81	1,528.50	27,536.39	13,949.10	1,067,226.23
603	363.90							640.38			2,198.20	3,202.48
604					337.08	92.41		1,157.30			2,707.81	4,294.60
605	771.92											771.92
607											118.40	118.40
611											60.00	60.00
612	16,896.70			37,364.78	1,200.00			2,445.12			303.00	58,209.60
613				8,383.32				611.28			1,162.96	10,157.56
622											3,347.70	3,347.70
623				50.21							435.15	485.36
624	1,178.08			2,000.00				1,000.00				4,178.08
627											2,025.68	2,025.68
628	184,878.42			1,974,672.94	23,704.60			49,516.98			414.00	2,233,186.94
635											2,045.00	2,045.00
625											482.10	482.10
626											68.32	68.32
641											14,702.00	14,702.00
645											4,124.00	4,124.00
6581	56.63										760.50	817.13
6588				872.80								872.80
6589											20,921.30	20,921.30
6583				(83.06)								(83.06)
665											25.89	25.89
666											11,953.74	11,953.74
668											(129.00)	(129.00)
681	754.04	2,248.50		244.48							17,351.93	20,598.95
TOTAL	737,982.05	2,248.50	6,810.69	2,228,117.78	73,381.27	92.41	123,965.48	162,972.87	1,528.50	27,536.39	99,027.78	3,463,663.72

Source: Author's processing.

Revenues in September can only be adjusting using the "712 Revenues associated with the cost of services in progress" account, either by increasing the amount of removals from stock, or increasing the production costs. A possibility to increase costs is the inclusion of some

general administrative expenses into the category of expenses directly related to productive activities. As it is highlighted in the situation of production cost (Table 3), the amount of general administration expenses is insufficient (99,027.78 lei).

The only remaining available option is altering the value of removals from stock. The project chosen for this operation is the most complex and highest in value, namely the X6 project. Also, from the production cost situation for the month of September it can be noted the significant value of services provided by third parties: 1,974,672.94 lei, of which 1,344,537.81 lei represents services rendered in July, but invoiced in September. The production for the project X6 in July was invoiced for the project in September. Consequently, the removal from stock of the production from July which was invoiced to the beneficiary in September is already more nuanced and includes:

- The amount of 402,077.95 lei, representing the actual production cost for the month of July (excluding services provided by third parties in July, but invoiced in September, amounting to 1,344,537.81 lei);
- The value of 1,344,537.81 lei, representing accounting services performed by a supplier in July, which were invoiced in September.

This structure of the amount removed from stock encourages its artificial increase, in order to achieve the objective, on the basis of the difference in the amount of

services provided by third parties: 1,974,672.94 – 1,344,537.81 = 630,135.13 lei (in fact, services received from and invoiced by suppliers related strictly to the month of September). The increase is performed with the amount of 560,413.89 lei (a random value slightly higher than the one resulting from the calculations, of 536,424.15 lei, because a round amount of income tax may be considered suspicious anytime). The technique relies heavily on the shortcomings arising from the mismatch of classifications and units of measurement used in the preparation of standard consumption sheets, statements from suppliers regarding the completion of a proportion of the contract work, surveys of work performed for the beneficiaries.

The erroneous amount removed from stock is corrected in October, by reversing the increased amounts from September. Performing those operations (increase or correction) is avoided at the beginning or end of the period. The effect of the technique is valid for a very short period of time, being obvious that, ultimately, the amount of income tax will increase significantly.

The final version of the determination of the income tax for the third quarter is as follows:

Total revenues (10.313.506,61-560.413,89)	9.753.092,72
– Total expenses (class 6)	– 9.345.492,63
= Income (121)	= 407.600,09
+ Total non-deductible expenses	+ 79.941,42
Taxable income	487.541,51
Income tax owed	78.007,00
Income tax recorded	31.845,00
Income tax to be recorded	46.162,00

Conclusions

Accounting information required for decision-making is not always found in the adopted decision. There are situations when, after it is made, management accounting is requested to support the already taken decision. Under these conditions, managerial accounting is given an unwanted role, that of “numerical burial” of the decision process. The reasoning is “upside down” and sometimes arises even in modern management accounting systems, either because of the need to achieve goals that need to bypass reality, or because of a rejection reaction of the new system.

Some of the most important issues of management accounting tools are the processes of traceability and rational allocation of costs. Obtaining accuracy is permanently limited by the cost of obtaining information. This issue is increasingly counterweighted by computer technology, which eliminates barriers in achieving accuracy. The cost of designing information systems that are suitable and adapted to the organizational needs is placed far below the advantages that such systems are able to generate. Limits show up in terms of cost accuracy, especially in the minds of those whose motto is “different costs for different goals”. Costs considered to be useful in particular situations do not

represent actual costs. Cost accuracy is regarded more from a decisional perspective than from an objective perspective. Subjectivity of the criteria for overheads allocation remains in force even if the transition to advanced manufacturing systems is performed. The effect is a decrease in direct labour and an increase in overheads. Replacing traditional allocation base (direct labour) with measures specific to new technologies (machine hours, occupied space, installed capacity etc.) does not solve the problem. There still is no causal link between the amount of resources consumed and the generating elements of these consumptions. The ABC method is not always a solution, either due to difficulties in its implementation, or because of its inadaptability to certain organizational environments. Moreover, this method also keeps alive a certain conventionality in allocating overheads.

Managerial accounting systems implementations in a national context primarily suffer due to the acute lack of professionals in the field and the lack of appropriate managerial vision. The assimilation of innovative ideas of managerial accounting into the Romanian business environment is extremely difficult, and these ideas are regarded with wariness. The academic environment still lacks enough force to facilitate the process of knowledge. The economic, political, legal and fiscal contexts represent genuine incentives to adopt practices contrary to the concept of real performance. Our opinion is that the implementation can only succeed amid the authority of multinational companies with tradition in the organization of managerial accounting systems. Only the knowledge and skills of the multinationals can “force” the Romanian practice to act within the limits of what should actually be an effective managerial accounting system. Legislative authority is rudimentary and easily defeated.

National mentality created and maintained by the environment in which it manifests itself is oriented towards extremely short-term gains. The mirage of immediate liquidity obtained by any means destroys any intention of efficient functioning for a system of management accounting. Survival strategies in the current conditions completely misrepresents the quality and relevance of accounting information. Stiffness, reluctance, hostility, inertia, ignorance are the viruses that the managerial accounting body is struggling with. Forced implementation leads to the exploitation of vulnerabilities in the implemented systems and the creation of a spotless functionality image. All these factors working together successfully places us in a stone age in terms of managerial accounting. On the opposite side, a few lights are perceivable, successfully lit by multinational companies.

There is a need to stimulate organizations to be more responsive to the innovations in managerial accounting. Professional accountants and the academic environment must act forcefully on this line, requiring additional empirical studies and field research. Research should aim at identifying and evaluating new managerial accounting systems, and also the analysis of motivational factors regarding the inertia manifested in the process of change. Aspects regarding the implication of the human factor in the implementation processes should not be ignored, requiring an intense demarche to increase familiarity with behavioural manifestations. A major goal should be represented by the “production” of an overview of the issues in managerial accounting, even if some of them are not yet clarified or will be never clarified. Thus, by means of these “warnings”, we will be ready to combat behavioural issues and avoid them before choosing a certain accounting system.

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Aspects of the impact of interest rate development on the probability of default

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Abstract

The acceptance of banking risks and their control is one of the key moments in banking activity. Success in banking management is possible only if the risks accepted by banks are reasonable, can be controlled and do not exceed the financial resources and their expertise.

The occurrence of the interest rate risk is due to the holding a portfolio of assets and liabilities with fixed interest, different in terms of maturities and price and in terms of ownership of assets and liabilities with variable interest that adapts differently to interest rate fluctuations.

The estimation of the probability of default is the first step to determine and assess risk. The major issues in the estimation of PD are generated by the limitation of the required information.

This work captures the impact of interest rate on the PD at maturity of loans. The analysis covers the period January 2013 - December 2015 using data on interest rates in the interbank market, the type of loans granted and the number of people that recored outstanding loans.

Keywords: Probability of default (PD), interest rate, credit risk, financial institutions, interest rate risk

JEL Classification: E00, G20, G21, G32

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Introduction

The policy of interest rate risk management lies in following closely with a relatively high frequency the present and projected financial impact that the implementation of the strategy or of the program in question.

The interest is the price of the capital used or the “rent” to be paid by the debtor for the right which is granted, that of using the borrowed capital. Generally, the interest rate level is correlated with the profit rate obtained by the entrepreneur. Quantification of the interest is achieved by using the interest rate, which is an instrument for influencing the demand and supply of credits.

A low interest rate leads to an increased demand for credits, resulting in favourable effects on production and economy, just as a high cost of credit generates lower demand.

This article attempts to capture the impact of interest rate on the probability of default upon maturity of loans. The analysis covers the period January 2013 – December 2015 using data on interest rates in the interbank market, the type of loans (treasury, for equipment) and the number of people who registered outstanding loans.

1. Literature review

This paper aims to highlight the role that interest rate development has on the interbank market and the destination of the loans granted by credit institutions on the probability of default at maturity of loans, given the prudential rules for credit risk.

An important part of the research literature is devoted to macroeconomic credit risk models following the methodology proposed by Wilson (1998). In his work “Portfolio Credit Risk”, he proposes a new methodology for determining the distribution of loss resulting from related events of credit risk, in case of credit portfolios chosen arbitrarily for non-financial companies, both regionally and across the sector. An improvement to this approach is the creation of a link between the loss distribution, and the state of economy, as opposed to the approach based on historical averages, unconditioned by the macroeconomic framework, which does not accurately reflect the credit risk in the current economic conditions.

Chen, Cheng and Wu (2013) developed a class of dynamic models analysing the LIBOR rate and the SWAP rates by using three interest rate factors. They start from the idea that the impact of the interest rate on each industrial sector and the rating class are governed by one or two dynamic factors. The authors reached the conclusion that enterprises in different industries present a different dynamic regarding the credit risk but, in all the cases, the credit risk is influenced by the interest rate dynamics. More than that, the evolution of the interest rate doesn't offer only information regarding the credit risk for the current credits, but it also predicts the future dynamic of the credit risk.

In the same time, Gambacorta and Mistrulli (2014) reached the conclusion that the interest rate of the short term credits is strongly correlated with the evolution of the three months interest rate on the interbanking market. The authors noticed that the interest rate during the economic crisis was negatively correlated with the percentage of the credits granted by the banks to the corporate sector and the number of years between the first registration of a debtor in the Credit bureau is negatively correlated with the change of the crediting conditions. In the same time, certain characteristics of the banks affect the evolution of the interest rate. Thus, the banks which have less liquidities and are poorer capitalised were less willing to protect their corporate customers as to the increase of the interest rate.

Dell'Ariccia (2014) shows that the maintenance of a low interest rate can contribute to the growth of taking bank risks. When the banks adjust the capital's structure, the reduction of the interest rate generates a stronger gear effect and assuming a higher risk.

Landier, Sraer and Thesmar (2013) showed, using a sample made up of the trimester data of a sample of USA holdings during 1986-2013, that the banks present a significant exposure to the interest rate risk. In the same time, the authors reached the conclusion that it is difficult for a company confronted with a reduction of the credits to find quickly alternative financing sources. This leads to a decrease of the investments and of the jobs, as well as to financial difficulties.

Koh, Wei and Chwee (2015) concluded that the use of credit-scoring can help the credit institutions to determine the interest rate that they should ask from their customers and to determine the prices of the consumers' portfolios that present a risk of not being reimbursed higher because of a higher interest rate applied.

According to Jimenez et al. (2014) whenever the monetary politics interest rates are smaller, the banks offer a bigger number of credits to the companies which present a higher risk.

Pesola (2001) proposed a dynamic panel approach for the study of banking crisis that affected the Nordic countries in the 1990s. The results of the study identify the indebtedness of borrowers as the most important explanatory variable that can approximate the level of financial fragility.

The integration of macroeconomic indicators in analyzing the credit risk was addressed, among others, by Castro (2013), who captured the link between macroeconomic indicators and credit risk, for a number of countries – Greece, Ireland, Portugal, Spain, and Italy (GIPSI), affected by the economic and financial crisis. Using a dynamic panel approach he notes that the credit risk is significantly affected by the macroeconomic environment: the credit risk increases when the gross domestic product (GDP) decreases, but the unemployment rate or interest rate increase, and are positively influenced by an appreciation of the real exchange rate .

Statistical techniques were used extensively in the construction of the classifying and credit-scoring model. Dănilă (2012) produced a scoring model to quantify the probability of default based on quantitative information and the determination of the power of predictivity of situations of default, given the determination of qualitative variables with regard to the impact on the repayment capacity of loan applicants.

Egami (2013) highlights a number of precautions measures to credit risk management using Levy processes and Sunet (2011) applied the multivariate exponential distribution Marshall-Olkin on credit risk. Meanwhile, Santoso et al. (2005) investigated bank failures in Japan and Indonesia using the logit model, while Canbas, Cabuk and Kilic (2005) proposed an integrated prediction system combining discriminant analysis, logit, probit and the analysis of main components.

2. Research methodology

The assessment of the default probability is the first step to determine and assess the credit risk. The major problems in the assessment of the default probability are generated by the limited available information.

To study the impact of interest rates on the number of debtors we have used the daily data of the reference rates ROBOR for a month¹, as they appear on the website of the National Bank of Romania, as well as the monthly series representing the total amount of treasury loans, of the loans for equipment and the number of debtors with overdue payments to the credit institutions for the period January 2013 – December 2015.

The research aims to determine the connection between the evolution of the interest rate and the probability of default of the persons asking for credits, but also is the credit's destination (financing current activity/treasury of equipment purchase/investment) influences the decisions of the persons asking for credits regarding the payment of the contracted credits at the due date.

For an objective approach, we used:

- the dependent variable *Number of distressed debt (DR)* – Y, and
- the independent variables:
 - Interest rate on the interbank market at one month (ROBOR1M) – X₁
 - Treasury loans – X₂
 - Loans for equipment – X₃;

as they appear on the internet page of the National Bank of Romania.

The research hypothesis is: The number of debtors with overdue credit payments depends on the evolution of the interest rate and the destination of the granted credits (treasury or equipment purchase).

In order to make the analysis we made empirical correlations between the dependent variable and the independent variables.

The variables subject to the analysis were worked so that they could generate a correlation matrix. It reflects the degree of influence of each independent variable on the default probability (**Table 2**).

In order to determine the correlation between the number of debtors with overdue payments and the dependent variables we analysed the data series with the EViews software package. We made the econometric analysis with logarithmic series, in order to facilitate the interpretation of the results obtained.

¹ For the analysis purpose, these were transformed in data series with month frequency

We estimate that an increase of the reference interest rate value generates an increase of the default value, while the increase in the credits granted for the treasury's financing or for the equipment purchase is associated with a decrease of the default probability.

3. Research results

After finalizing the information's collection process for each variable analysed we obtained a database structured in Table 1.

Table 1. Database with the values of the main variables

	ROBOR1M	Owed amounts; treasury credits	Owed amounts; equipments credits	Number of debtors with overdue payments (companies)
	(% p.a.)	(mil. RON)	(mil. RON)	(pers.)
	X ₁	X ₂	X ₃	Y
December 2015	0.72	77,366	34,983	40,695
November 2015	0.87	77,228	35,140	43,189
October 2015	1.21	76,682	34,795	42,516
September 2015	1.41	76,267	33,982	42,842
August 2015	1.14	76,373	34,007	42,379
July 2015	1.01	75,404	33,824	41,604
June 2015	1.07	75,413	34,071	43,342
Mai 2015	1.27	74,090	33,792	43,615
April 2015	1.44	74,290	33,661	42,852
March 2015	0.91	68,013	30,348	42,890
February 2015	0.71	67,818	30,397	44,130
January 2015	0.72	67,947	30,335	43,803
December 2014	0.85	67,679	30,837	44,197
November 2014	1.10	67,614	31,237	45,196
October 2014	2.54	67,575	31,239	44,599
September 2014	2.85	67,170	30,873	45,650
August 2014	1.96	66,726	31,023	46,145
July 2014	1.79	66,596	30,875	45,425
June 2014	2.00	66,572	30,490	47,468
May 2014	2.56	66,480	30,553	47,753
April 2014	2.62	66,162	30,184	47,922
March 2014	2.43	65,571	30,167	47,604
February 2014	3.48	65,636	30,268	48,392
January 2014	1.63	65,901	30,172	48,011
December 2013	2.00	65,749	30,163	47,781
November 2013	1.98	65,620	29,448	49,723
October 2013	2.95	66,089	29,909	48,911
September 2013	3.50	65,611	30,213	50,488
August 2013	3.81	66,036	30,247	48,632
July 2013	4.53	65,556	30,096	48,045
June 2013	4.41	66,288	30,297	49,761
Mai 2013	3.82	65,437	29,877	48,499
April 2013	4.40	64,995	29,881	48,773
March 2013	5.27	66,166	30,397	49,170
February 2013	5.84	65,791	30,220	49,715
January 2013	5.97	65,670	30,533	48,104

Source: <http://www.bnr.ro> and authors' processing

The correlation matrix of the variables analysed (Table 2) shows the fact that the high values of the interest rate are associated with high values of the default probability. This fact is emphasized by the positive value of the correlation between the default value and the evolution of the interest rate (0.776457985).

In the same time, the negative values of the correlations between the default value and the treasury credits (-0.839065268) or the credits for the equipment purchases (-0.809370191) show that the high values of the independent variables are associated with small values of the default value. In the same time, the small values of the independent variables are associated with high values of the default probability.

Table 2. Correlation matrix of the analysed variables

	Number of debtors with overdue payments (companies)	ROBOR1M	Owed amounts; treasury credits	Owed amounts; equipments credits
Number of debtors with overdue payments (companies)	1			
ROBOR1M	0.776457985	1		
Owed amounts; treasury credits	-0.839065268	-0.59165719	1	
Owed amounts; equipments credits	-0.809370191	-0.53445578	0.983583041	1

Source: authors' processing, 2016

In order to show the dependence between the selected variables in the chosen time frame we estimated the regression model in Excel (Table 3).

Table 3. Estimation of the regression model in EXCEL

SUMMARY OUTPUT	
Regression Statistics	
Multiple R	0.908505008
R Square	0.825381349
Adjusted R Square	0.809010851
Standard Error	1217.305525
Observations	36

Source: authors' processing, 2016

We can notice that the evolution of the number of debtors with overdue payments (companies) is influenced in proportion of 82.54% by the interest rate and the destination of the granted credits (R Square = 0.82538135).

Next, we made the analysis of the data series with EViews in order to determine the correlation between the number of debtors with overdue payments

(companies) and the independent variables which were subject to analysis.

The check the hypothesis of the normality of the errors we used the Jarque-Berra test. This is based on the hypothesis that the normal distribution has an asymmetry coefficient equal with zero and a aplatisation coefficient equal with three. If the probability associated with the computed value of the test is low enough (the probability associated with the test doesn't exceed the table value), the hypothesis of errors' normality can be accepted.

The analysis of series histograms highlighted that these show characteristics of abnormal distribution having an *Kurtotic excess (distribution is leptokurtotic)*, which reveals the existence of a great possibility to record extreme events (large variations in the interest rate or in the number of creditors that record overdue payments).

With the help of the linear regression we can determine the impact of the independent variables on the evolution of the number of debtors with overdue payments (companies).

The econometric results regarding the impact of interest rates and of the destinaton of loans granted on the probability of default at maturity of loans is as follows:

Table 4. Research results in relation to independent variables

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Dependent Variable: L_Y Method: Pooled Least Squares Date: 05/15/16 Time: 08:58 Sample: 2013M01 2015M12 Included observations: 36 Cross-sections included: 4 Total pool (balanced) observations: 144				
C	14.03511	0.468392	29.96444	0.0000
L_X1	0.078321	0.004148	18.88015	0.0000
L_X2	-0.048632	0.051414	-0.945899	0.3455
L_X3	-0.122599	0.029612	-4.140125	0.0001
Fixed Effects (Cross)				
_X1--C	4.56E-16			
_X2--C	4.56E-16			
_X3--C	4.56E-16			
_X4--C	4.56E-16			
_Y--C	4.56E-16			
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.842403	Mean dependent var	12.27860	
Adjusted R-squared	0.835989	S.D. dependent var	0.064041	
S.E. of regression	0.025935	Akaike info criterion	-4.422994	
Sum squared resid	0.115694	Schwarz criterion	-4.281085	
Log likelihood	406.0694	Hannan-Quinn criter.	-4.365456	
F-statistic	131.3412	Durbin-Watson stat	1.819591	
Prob(F-statistic)	0.000000			

Source: authors' processing, 2016

As the probability associated with the t test is lower than the most restrictive relevance level (1%) for the variables X_1 (interest rate) and X_3 (credits for the equipments), but is above this level for the variable X_2 (treasury credits), the null hypothesis is rejected in the case of the variables X_1 and X_3 (the coefficients associated with these variables are significant from the statistical point of view) and is accepted in the case of the variable X_2 (the coefficient associated with this variable is not significant from the statistical point of view).

In the same time, the probability associated with the F test shows that at least one of the regression coefficients is significant from the statistical point of view.

Considering that the dependent and the independent variables are expressed in natural logarithms, the independent variables coefficients shows with what percentage is changing the dependent variable at a change with one percent of the independent variables. Thus, an increase of 1% of the value of the interest rate will determine an increase of 7.8321% of the number of bad debtors. In the same time, an increase of 1% of the treasury credits will determine a decrease of 4.8632% of the number of bad debtors. An increase of 1% of the credits for the equipment purchases will determine a decrease of 12.26% of the number of bad debtors.

According to the econometric results the number of debtors to credit is influenced by the interest rate,

meaning that an increase in interest rates on the interbank market determines an increase in the probability of default at maturity of loans contracted, while the destination of loans contracted (equipment, treasury) does not significantly influence PD.

Conclusions

The financing by banks of certain activities in the field of industry, construction, agriculture, services or trade enables companies to increase the quality and volume of products and services provided. Also, a better orientation of these companies to the requirements of domestic and foreign markets takes place with beneficial effects on the reduction of macroeconomic imbalances inherent in an economy which is in full process of recovery of gaps as compared to the standards of developed countries.

The banks are confronted with the interest risk because of the exposure to unfavourable fluctuations of the interest rates on the market. As the interest bearing assets and liabilities become due, the market value of the assets and liabilities is influenced by the variance of the interest rate. The interest rate changes in different moments and in different percentages.

Under the circumstances of the economic crisis, banks have become more selective in providing financing to companies. Interbank liquidity maintenance below the high level recorded before the outbreak of the international economic crisis, and the financial difficulties registered by certain clients, will lead to a strategic reorientation of corporate lending, as follows:

- Financing mainly of investment projects along with a European partner (BERD, BEI) or by the government. This strategic shift will take place in the context of decrease of the indebtedness of the private sector and of the increase of the government indebtedness in the long term.
- Carefully analyzing the phases of the economic cycle and avoiding as far as manageable, the concentration of funding in sectors with a growth rate far too high at present and untenable in the long term.
- Focusing on the safety of investments made and diminishing the probability of materialization of credit risk by requiring additional securities or government securities.

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