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Accounting Books as a Source of Information and the Basis for Civil Liability

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Abstract

Purpose: The aim of the paper is to present inconsistencies in keeping accounting books and legal effects concerning dishonest keeping or not keeping accounting books.

Design/methodology/approach: Analysis of legal acts and statistical data on the penalties imposed and court judgments for violation of legal provisions in the preparation and presentation of financial statements.

Findings: The scope and size of inconsistencies in financial information indicate the growing role of compliance and application of ethical standards and the Code of professional ethics in accounting.

Research and practical limitations/implications: The findings provide recommendations to implement new standards and procedures for improving the quality of information presented to stakeholders and to separate the functions of the executive and control functions related to bookkeeping.

Paper type: research paper.

Keywords: financial statements, criminal responsibility, ethical standards, accounting.

1. Introduction

In the contemporary economy financial reports play a significant role, that is because of their comparability and the scope of included information. The purpose of accountancy is to provide appropriately prepared and presented financial information, which is necessary for making decisions in various aspects concerning a business entity, e.g.: financial, tax, monitoring, investment. This is possible because it serves many purposes that allow to monitor an entity, and to analyse its operations, to fulfil reporting, evidence and billing obligations, as well as to provide information for statistical purposes. Financial reports are prepared on the basis of accounting books, the regulations for which are determined individually in particular countries all around the world. Solid accounting books constitute an important source of information for entities, which prepare them, as well as for different groups of stakeholders. They contain essential information used for preparing financial statements, reports and declarations, including the ones prepared for public purposes. Therefore, they raise understandable interest among managers, financiers, analysts, investors, state authorities and scientists. Keeping accounting books diligently and in accordance with ethical standards has economic significance not only from the macroeconomic and microeconomic perspective, but also from the social perspective.

Emergence of the global market means development of international institutions and corporations. However, even small companies operating locally are subject to influences of global factors, facing opportunities or threats, which the international environment generates. They are obliged to implement changes resulting from international determinants and are subject to the same legal regulations as corporations. Therefore, emphasising the importance of the diligence in keeping accounting books one cannot be limited to only legal aspects and requirements set by legal regulations contained in legal systems of individual countries, as well as in international standards related to financial reporting and accounting. Ethical standards are also important and they influence international cooperation within the frame of non-governmental organisations which operate in different countries of the world.

Ethics is an important element in the functioning of a business activity and in social life, defined as a set of conduct rules, which translates into operations and serves the higher good above caring for one's own interest. People who deal with accounting should keep high ethical

standards, despite the fact that applying them requires certain sacrifices. Providing stakeholders with reliable and objective information, most of all free of mistakes, can facilitate making decisions. It can eliminate or mitigate negative effects of wrong decisions. In extreme situations in business practice there are situations of deliberate and conscious distortion of the financial situation and influencing economic results and indexes. Therefore, observing all the ethical rules and standards is perceived simply as honesty and constitutes one of the elements building an image of a company.

There are non-governmental organisations which assist professional accountants, through supporting them with guidelines, norms, standards, as well as professional certificates. All those operations are necessary in the process of providing appropriate quality of financial reports. Unfortunately, the employee's knowledge and their high qualifications are not always appreciated by employers and they do not translate into reliability of accounting books and observing ethical standards. Limitations resulting from the Accounting Act, related to the obligation to verify financial reports and liberating the profession of accounting services, do not make it easier to provide information concerning reliability of accounting books and observing ethical standards in accounting.

The aim of this article is to present inconsistencies in keeping accounting books and legal effects concerning dishonest keeping or not keeping accounting books. For this purpose an analysis of literature and statistical data concerning legally valid court rulings was conducted.

2. Professional liability and creative accounting

Individuals dealing with accounting are considered to be specialists, who are cunning enough to manipulate money and people. Therefore, high ethical standards in accounting are related with honesty and diligence of presenting financial reports. Currently, it is not possible to imagine the world functioning without accounting, which allows to explain observed phenomena. An accounting entity is in each business unit, regardless of its size and processes it realises (Skrzywan, 1973, p. 15).

In the dynamically changing market environment there are companies that could become engrossed in their operations. Therefore, they need to be made aware that the essence of accounting in an organisation

is presenting a true and diligent view of the financial situation of an enterprise in a given moment, so that this information is sufficient, precise and reliable for all users (Grosanu, Rachisan and Berinde, 2012, p. 668). Furthermore, it needs to be emphasised that the role accounting plays in business entities makes it has social responsibility for information generated by them.

It needs to be emphasised that honest accounting suffered significantly because of more and more frequent abilities and unlimited imagination of some accountants. Their actions combine knowledge and experience in accounting with creativity and legal loopholes in legislature. The techniques presented above are only some of techniques used by accounting specialists, or even managers, often in cooperation with auditors, in order to create a desired image of the company (Balaciu, Bogdan, Feleaga and Popa, 2014, p. 644). This is how practices of creative accounting started to emerge, which was developing most dynamically in the end of the 1980s (Healy and Wahlen, 1999, p. 367). It is worth mentioning that from the beginning the issue of creative accounting was perceived from two different perspectives. One of them was positive, as it was assumed that creative skills of accountants could be used for the good of an organisation in accordance with legal regulations. Whereas, on the other hand using such techniques to commit frauds and act against the law was not approved (Fragalla, 2015, p. 137).

As time passed, creative accounting became a very controversial issue, which was described in professional literature more and more frequently (Khatri, 2015). The key problem related to this issue resulted from an ethical dilemma of an accountant, who decided to use the techniques of creative accounting.

The temptation of being able to choose from legal solutions and approved standards means that for many business entities the objective of applying creative accounting is (Surdykowska (Ed.), 2005, pp. 27–33):

- to hide actual situation of an enterprise from its stakeholders;
- to reduce taxes;
- to reduce loses or to increase profits;
- to manipulate financial indexes;
- to convince others, including business partners and lenders, of a firm credibility;
- to hide financial risk;

- to manipulate achievements of managers and directors in order to receive bonuses granted for realisation of objectives and results;
- to avoid negative effects which could result from inspections conducted by stakeholders;
- to make it possible to obtain capital which would be unavailable otherwise.

The reasons that make business entities use the above solutions could be numerous and they include among others:

- yielding up to the pressure from stakeholders;
- the will to present the enterprise in a good light;
- the possibility to influence the amount of paid dividend;
- obtaining new financing sources;
- obtaining a bonus or other benefits by the managing staff.

Apart from creative accounting the concept of aggressive accounting has also been introduced including conscious, intentional and deliberate registration, record keeping, processing and presenting business operations against regulations, or based on wrongly and partially interpreted regulations and accounting practices in order to present the users with a different (better or worse) situation in an enterprise (Gut, 2006, p. 11). Both creative and aggressive accounting can ultimately lead to malpractices in bookkeeping, or not keeping them at all.

Entities which commit the above-mentioned acts can be the owners of a business entity, the managing staff in this entity or its employees. Results of such actions can be perceived from the micro- and macroeconomic perspective. From the microeconomic perspective this mostly means losing property, which usually leads to bankruptcy of an enterprise. Whereas from the macroeconomic perspective such misbehaviours present in large corporations lead to increased unemployment, recession and in consequence to an economic crisis.

Performing an assessment of credibility of an enterprise one needs to emphasise that it influences the level of trust from stakeholders and proves business maturity of an enterprise, which combines the economic and social aspects. Ensuring credibility in an accounting system is of utmost importance in a socially responsible enterprise.

In the Polish accounting system credibility has not been defined. Aspiring to faithfully express the situation of a business entity in contemporary financial accounting systems is connected with the necessity to follow certain standards contained in the legal system

(e.g. Accounting Act), or a collection of standards, e.g. International Financial Reporting Standards (IFRS) (Wójtowicz, 2010, p. 41). All the norms, standards or initiatives relating to social responsibility of enterprises assume credibility as an essential principle of presenting data.

Responsibility in accounting is related with penal issues of the Accounting Act. This question is rarely raised in scientific forums. However, payment gridlocks, dishonest contracting parties, employers and employees committing embezzlement, professional crime groups specialising in wangling money, or fraudsters using fake documents become an obstacle on the way to ethical business conduct. Therefore, such behaviours require in-depth insight in the penal aspects of the Accounting Act (Kamela-Sowińska, 2015, pp. 142–143). Criminal liability is included in article 77 of the Act of 29 September 1994 on accounting and it assumes that whoever, against the regulations of the Act allows for: not keeping accounting books, keeping them against the regulations of the Act, or providing dishonest information in these books, as well as not preparing a financial report, a consolidated financial report, a business activity report, a report on capital group operations, a report on payments for public administration, a consolidated report on payments for public administration, preparing them against the regulations of the Act, or including dishonest information in those reports – is subject to a fine or imprisonment up to 2 years, or both these punishments combined. The obligation to indicate the person responsible in charge contained in the Act, in accordance with article 4 item 5, refers to the unit manager who is responsible for carrying out the duties of accounting specified in the Act. To sum up, it is worth noticing that responsibility for honest and reliable accounting is a legal matter and results from legal determinants and other commonly prevailing standards.

3. Criminal liability for dishonest bookkeeping

In recent decades business activities have generated numerous problems in contemporary economy. The society and most of all public opinion more and more frequently expect from business entities ethical conduct and taking responsibility for their operations. However, it is difficult for business entities to find a balance between maximisation

of profit, increasing the value of a company for the owners and the responsibility for, not always ethical, methods used for achieving business objectives (Friedman, 1970). The issues related to responsibility in theory and practice of accounting and legal regulations constitute an important problem both in the global economy as well as in Polish enterprises. Financial scandals, frauds, corruption and various irregularities occurring in economic practice have led to appointing various government and non-government organisations, aiming at supervising correct application of legal regulations both of national as well as international origin. Introducing international standards allows to eliminate differences and harmonise regulations. However, international solutions, apart from regulations that business entities must abide by, do not contain information concerning responsibility for improper application of standards or even breaking them. They focus mainly on standardising and harmonising solutions, and do not concentrate on the responsibility that should be borne by business entities obliged to observe them for infringement thereof. At the same time we can notice how the role of responsibility increases in the economy, which is significantly and more and more clearly influenced by the growing role of business activity in the development of contemporary civilisation. One of the main management instruments in today's economy is considered to be accounting whose functioning and practical application has been conditioned by numerous legal acts. Misinterpretation of those regulations, misunderstanding of responsibility, an error or a fraud can result in multidimensional consequences, which are very dangerous (Gabrusewicz, 2010, p. 10). Furthermore, the area that is difficult to identify in terms of responsibility is the emergence of culpable and non-culpable errors in business entities, which appear in an entity when collecting documents, processing them and presenting reports created on their basis.

Legal responsibility is of a unique nature, which is related directly to violating legal standards. The scope of responsibility, which entrepreneurs as well as accountants have in regard to observing accounting regulations, keeping accounting books and preparing financial statements, is contained in national legal regulations such as the Accounting Act, penal code or tax penal code and is also enforced at the national level. In criminal law, responsibility occurs when there are various pieces of evidence. Most importantly, a committed offence must meet the features of a prohibited act, the social harm of an act is greater than

insignificant, and the offender at the moment of committing the act was able to understand its meaning and able to act on his own will.

4. Legal consequences for dishonest bookkeeping

The act on accounting regulates accounting procedures, keeping accounting books and the procedures of inspecting financial reports by expert auditors. It also regulates the scope of criminal liability for not observing the regulations contained in the act. The article 77 of the Accounting Act of 29 September 1994 specifies criminal liability for:

1. not keeping accounting books, or keeping them not in conformity with and against the regulations of the Act, as well as providing dishonest information in accounting books;
2. not preparing a financial report, including dishonest information in it, as well as preparing a report not in conformity with the regulations of the Act.

Individuals proved to commit the above-mentioned offences are subject to a fine, or imprisonment up to 2 years. They can also be subject to both penalties combined. Similarly to the case of accountants, the legislator imposes, in article 78 of the Accounting Act, the responsibility on expert auditors. An expert auditor is subject to a fine or imprisonment of up to 2 years if he/she prepares an opinion on a financial report of the audited business entity and accounting books which are the basis of preparing the report and expresses an opinion that is not reflecting the actual financial and property situation of this business entity. If an expert auditor acts unintentionally, and presents a dishonest opinion, is subject to a fine or restriction of personal liberty.

According to statistical data of the Ministry of Justice of Poland in reference to the Accounting Act of 29 September 1994, between 2001 and 2014 there were pronounced in total 4670 final and binding sentences, which is presented in Table 1.

Analysing the data collected in Table 1, it cannot be determined what character of operations was run by business entities, in which people in charge of the honesty of accounting books and preparing reports were sentenced with final and binding sentences. Neither can we determine the organisational form, nor the size of the entity. The number of pronounced sentences is not directly related to changes and amendments in the Accounting Act. Although the largest number of

Table 1. Final and binding sentences for adult people pursuant to article 77 of the Accounting Act of 29 September 1994

Year	Total number of sentences (Accounting Act)	Not keeping accounting books, keeping them in violation of the regulations of the Act or providing dishonest information in these books (article 77, item 1)	Not preparing financial reports and other reports, preparing them not in conformity with regulations of the Act or including in these reports dishonest information (article 77, item 2)
2001	42	3	19
2002	24	1	14
2003	55	11	16
2004	141	36	36
2005	169	47	22
2006	219	58	45
2007	234	41	38
2008	417	56	66
2009	416	53	67
2010	455	51	54
2011	446	42	55
2012	549	54	85
2013	802	66	128
2014	701	42	125
Total	4670	561	770

Source: Own work based on data provided by the Department of Management Statistical Information of the Department of Strategy and Deregulation at the Ministry of Justice on 23 September 2013 and 26 August 2015.

changes in the Act took place in 2009 (5 changes), in 2009 the number of sentences in relation to 2008 remained unchanged. On the basis of presented statistical information we can observe a constant increase in the number of pronounced sentences, and therefore the increase in detecting irregularities related to keeping accounting books and prepared reports. These changes are presented in Figure 1.

Analysing the data presented in Figure 1, it can be concluded that the number of final and binding sentences has been increasing in the period under the study. In 2001, there were 42 final and binding sentences,

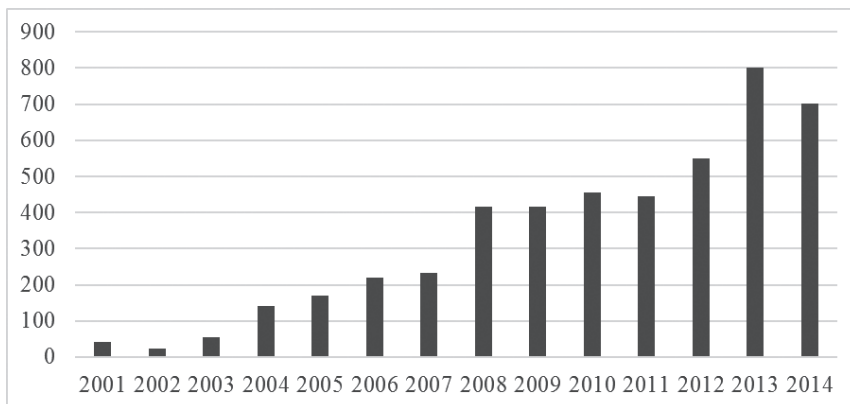


Figure 1. Final and binding sentences for adult people on the basis of the Accounting Act of 29 September 1994 [N of sentences]

Source: Own work based on data provided by the Department of Management Statistical Information of the Department of Strategy and Deregulation at the Ministry of Justice on 23 September 2013 and 26 August 2015.

and in 2014 there were as many as 701, which means that there was an increase by more than 16 times. Observing yearly changes between 2001 and 2014, we can notice that the largest increase took place in 2013. However between 2001 and 2003 the number of sentences did not exceed 100 a year, in the following two years 2004–2005 the number of 100 sentences a year was exceeded. 2006–2007 saw more than 200 sentences a year. In the following years there were more than 400 sentenced people. The increasing tendency is maintained, and in 2013 it exceeded 800. In 2013 in relation to 2012 the number of sentences increased by more than 250 sentences, which constitutes 146% in relation to the previous year. The number of final and binding sentences between 2013 and 2014 was increasing despite the fact that the legislator did not introduce multidimensional changes and the Accounting Act was not amended during this period. Significant changes related to preparing reports were introduced in 2015, furthermore micro- and small businesses were isolated, and new report forms were introduced for these entities (chapter 4 and 5 of the Accounting Act).

In the analysed period, an increase in pronounced sentences is observed, however the number of sentences cannot be directly connected with the number of business entities. The number of entities keeping dishonest accounting books has been changing and the largest number of sentences was pronounced in 2013, as presented in Figure 2.

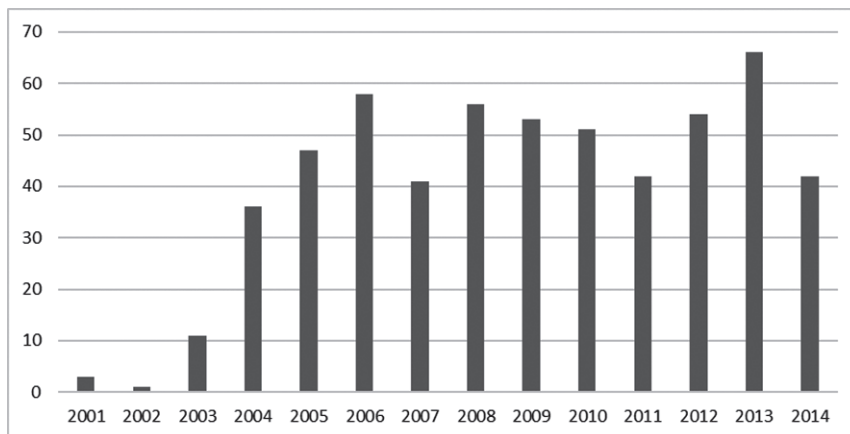


Figure 2. Final and binding sentences of adult people pursuant to article 77 item 1 of the Accounting Act of 29 September 1994 [N of companies]

Source: Own work based on data provided by the Department of Management Statistical Information of the Department of Strategy and Deregulation at the Ministry of Justice on 23 September 2013 and 26 August 2015.

Similarly to the sentences for dishonest bookkeeping, which have been fluctuating, the number of sentences related to not preparing or preparing financial reports inappropriately has been rising in the period under the study. The most significant increase in the number of sentenced entities was observed in 2013 and 2014 (cf. Figure 3).

Referring to the data provided by the Ministry of Justice we can notice that in 2013 the total number of people who were taken to court was 1796, out of which 802 people were sentenced (including 20 people who were imprisoned), and 989 of the people who were taken to court were conditionally discharged. In 2014 the total number of people who were taken to court was 1526, out of which 701 were sentenced (including 19 people who were imprisoned), and 823 people who were taken to court were conditionally discharged. Statistical data does not contain information concerning the period when the trial was proceeded, from the moment of initiating proceedings to the moment the sentence came into force.

On the basis of the presented results we only know the number of sentenced people, which is successively increasing. The root causes of such a situation cannot be explicitly determined. However, it may be assumed that they included:

- increased number of inspections;
- tighter control of legal regulations;

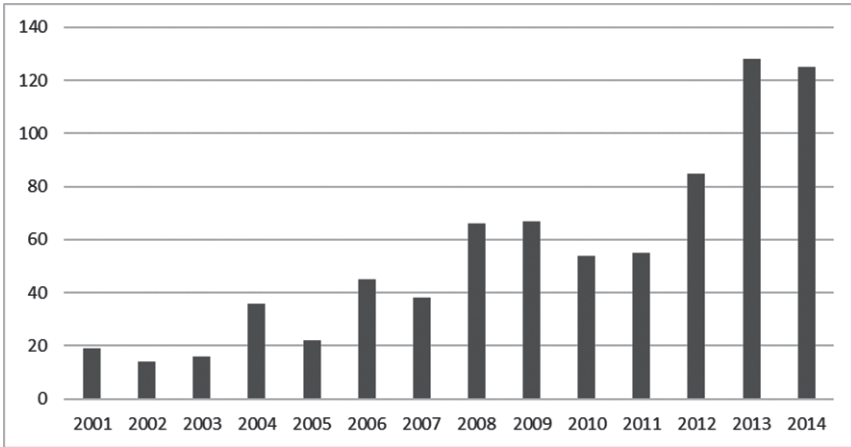


Figure 3. Final and binding sentences of adult people pursuant to article 77 item 2 of the Accounting Act of 29 September 1994 [N of sentences]

Source: Own work based data provided by the Department of Management Statistical Information of the Department of Strategy and Deregulation at the Ministry of Justice on 23 September 2013 and 26 August 2015.

- instability of legal regulations;
- numerous changes and amendments that hinder observing the law;
- economic crisis;
- seeking a quick profit;
- not observing ethical standards in business.

The increasing number of sentences suggests the lack of control over business entities obliged to keep accounting books and preparing financial reports. Article 64 of the Accounting Act provides the obligation for controlling financial reports for entities which prepare annual consolidated financial reports for capital groups and reports for entities which continue operations which were listed in this article. Furthermore, the research on reports also concerns entities, which in the previous trading year, for which a report was prepared, met at least two of the following conditions:

- annual average employment (i.e. full-time employees) amounted to at least 50 people;
- the total of asset balance at the end of the trading year constituted an equivalent in the Polish currency of at least 2,500,000 euros;

- net profit from selling goods and products as well as financial operations for a trading year constituted an equivalent in the Polish currency of at least 5,000,000 euros.

On 12 June 2013, the European Parliament implemented the regulations limiting the number of business entities being subjects to inspections. Large and medium enterprises and all the entities of public interest, and large and medium capital groups as well as the ones that include entities of public interest are subject to inspection at the level of the European Union directive. Member states are left with the option to determine thresholds for inspecting financial reports at the level appropriate to the situation of the state economy, for those entities which in the directive were specified as small enterprises. Many Polish business entities are not subject to report inspections. There are also enterprises which meet the legislator's requirements only in specific periods of business activity, however in the following years they are not always subject to inspection, because their financial situation changes. This means that keeping accounting books and preparing reports is based on individual solutions applied in an entity and inspections for balance purposes are not carried out. This causes substantive irregularities to arise, which can concern an accounting policy drawn up for an entity, an analysis and register of accounting evidence, data in accounts, used methods of valuation or making an inventory, as well as mistakes in preparing financial reports.

5. Conclusion

Accounting books are a universal tool which allows to combine accounting records and collecting and processing data for balance purposes, taxation purposes and solutions contained in International Standards in Financial Reporting and sector guidelines. The scope of legal requirements varies, there are no unified regulations contained in the Accounting Act and international standards. Therefore, eliminating or reducing occurring irregularities should include the entire chain of financial information supply (Surdykowska, 2004, pp. 427–428). For this purpose it needs to be referred to social business responsibility, good practices and ethical norms contained in professional ethical codes. In order to remedy the situation a number of recommendations should be specified for the managing staff, which could influence the

quality of keeping accounting books. Above all, an analysis of possible changes should be conducted in order to, in particular:

- introduce substantive and organisational supervision concerning the functioning of accounting departments;
- prepare procedures including, among others, document circulation, the scope of registering work, the schedule of preparing financial reports and the rules for archiving documents;
- separate executive functions from inspection functions in the field of accounting;
- increase participation in training courses (including management staff of the higher and medium level) aiming at developing appropriate business attitudes with the objective of preventing negative effects related to misuse and accounting frauds.

Furthermore, in the contemporary world good law and modern technological solutions are not enough, over the years we can notice how important are the professionalism and ethical attitude of employees of financial and accounting departments. Therefore, one should not marginalise the role of professional accountants who apply professional ethics code in their work, in order to improve the quality of keeping accounting books and the presented financial information.

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