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THE ROLE OF ACCOUNTING ENGINEERING IN SHAPING THE BALANCE POLICY OF A COMPANY

Leszek Michalczyk[1]

Abstract

The issue discussed in the present paper is associated with a theoretical view of accounting engineering in which it is perceived as covering activities based on the use of variant solutions permitted by Polish balance sheet law. These possibilities are defined as the accounting policy of a given company. Keeping the accounts of a business enterprise in accordance with the accounting engineering paradigm requires a full use of codified variant accounting. The accounting policy of a company should, in these respects, be characterized by entries which are the least precise and the most facultative. The view of accounting assumed in the present article sees it as an auxiliary science for management and organizational studies. In this respect, it is also synonymous with recognizing accounting engineering as a paradigm of company management.

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Introduction

The structure of accounting methods within an entity should facilitate the attainment of its objective. If the goal requires the entity to achieve certain financial ratios, one of two approaches may be adopted. These are:
1) accounting engineering,
2) creative bookkeeping,
3) praxeological bookkeeping – definitions in: (Michalczyk, 2011).

The definitions reflect current trends in accounting methods (Michalczyk, 2005a, p. 289-298). The approach embraced in this article is that of accounting engineering, which makes use of variant solutions in accounting practice. For the purpose of the present article, we define variant accounting as a set of variant (alternative and optional) solutions available in Polish balance sheet law. Such solutions are characterised by different "fragmentary" financial results of identical economic operations. Having been sanctioned by the law, those solutions find a useful application in business practice.

[1] Ph. D. Leszek Michalczyk, Politechnika Krakowska, Instytut Ekonomii, Socjologii i Filozofii, Kraków, e-mail: 50sas21@wp.pl.

The Polish balance sheet law covers, above anything else, the following:
1) the Polish Accounting Act,
2) the International Accounting Standards (IAS),
3) the Polish Accounting Standards.

The issue we are concerned with in this article is accounting policy and those of its elements which would facilitate the practical application of accounting engineering.

Locating the concept of accounting policy within the theoretical framework of Polish accounting

According to IAS 1 (*Presentation Of Financial Statements*), accounting policy is defined as a set of rules and methods for estimating conventional values, and procedures regarding the presentation of financial statements.

The Polish balance sheet law gives business entities a free hand in choosing the method of valuating and accounting for assets and ongoing economic operations (*Ustawa…*, art. 3, ust. 11). Such individually chosen methods are considered correct if they operate within the boundaries set by the provisions of the balance sheet law. Those methods are a constituent part of an entity's accounting policy (Michalczyk, 2012b, 2012c, p.147-165).

Accounting engineering encompasses accounting operations which fall within the category of accounting micro policy (Brzezin, 1998, p. 26). The micro policy of accounting subordinates the principles adopted by an entity as part its accounting policy to the following factors:
1) objectives set by the entity's owner,
2) conformity with the current legal interpretation of the balance sheet law and the adopted standards of accounting (Pisarska, 2007, p. 177-183).

As such, the aforementioned principles of accounting micro policy lay the foundations for accounting operations as understood by *accounting engineering*. Accounting engineering corresponds to the means of performing accounting operations, whereas accounting policy is concerned with general principles to be applied by an entity (Michalczyk, 2011a, p. 132-140).

Before accounting engineering may be incorporated into the accounting policy of a company, company objectives first need to be clearly defined and linked to the options made available by legally-sanctioned variant accounting methods. Such objectives typically involve operations affecting:
1) the financial result – maximising or minimising the reported financial performance,
2) the goodwill of a company – adjusting it to the strategic objectives in company management,
3) the tax result – to influence the amount of cash available in respect of the net working capital management.

The constituent elements of accounting policy are enumerated in article 10 of the Polish Accounting Act. Article 8 of the Act, IAS 8 and, to some degree, IAS 1 are also of importance to accounting engineering. In the case of IAS 1, accounting policy corresponds to "accounting methods" adopted by an entity.

These regulations also allow entities to change their accounting methods at the start of the next accounting period (Czerwiński, 2005, p. 16-19). This results in the requirement to conduct an analysis showing the effect of such changes on the comparability of financial statements from the two periods. The analysis is typically contained in the *footnotes* to the financial statements of an entity. However, it is only attached to the statements concerning the period in which the changes were implemented. When an entity's economic performance over a longer period of time is reviewed, the analysis is not included. The changes may affect the moment when cost accounting is done, moving it forward in time or delaying it. In the end, the repercussions of the changes alter the financial statements of the entity, as well as the value of its fixed assets, long-term investments and inventory.

Keeping the accounts of a business enterprise in conformity with the accounting engineering paradigm requires a full use of codified variant accounting. The accounting policy of the entity should, as such, incorporate regulations which would be just as imprecise and facultative as the balance sheet law.

The possibility to choose accounting methods individually derives from codified variant accounting. Each business enterprise specifies its selection of methods in its accounting policy. However, the best opportunities for adopting accounting engineering measures arise when the methods for the following elements are chosen:

1) calculation of depreciation value (in.: Michalczyk, 2007, p. 83-103; Michalczyk 2005b, p. 266-275),
2) creating, calculating and releasing provisions (in.: Hajduk, 2003, p. 315-332),
3) calculating prepayments and accruals,
4) accounting for production when different goods are produced by one entity (Michalczyk, 2006a, p. 266-275; Michalczyk, 2006b, p. 102-124).

The assumption here is that the depreciation of assets may have different economic variants. Each entity may therefore choose, at its own discretion, its depreciation methods, e.g. apply the straight-line method to some of its fixed assets and, at the same time, adopt the declining method with respect to others. What needs to be unambiguous however is what methods of inventory valuation (with the exception of production as in the situation described above) and allocation have been chosen. As for inventory allocation, one may use standard prices calculated for the total volume of a given category (here separately: goods, materials and raw materials, semi-finished products, and products). This may be important whenever the turnover rate for individual inventory items differs considerably from item to item (in: Michalczyk, 2005a, p. 475-492; Michalczyk 2005c, p. 286-301).

The management board determines the scope of influence of the methods that have been adopted. International Accounting Standards recommend what path the management should take when it comes to deciding which legally-sanctioned accounting methods to choose (Rybicki, 2005, p. 33). The decision should be made in consideration of the prudence, materiality and substance-over-form principles (alike: Czerwiński, p. 16-19, other: Michalczyk 2012a, p. 121-131, Michalczyk, 2011c, p. 88).

The debate over the difference between accounting policy and balance policy, which has preoccupied Polish specialists for several years, is reflected in the "geographical" definitions introduced by Sawicki. He stipulates that accounting policy refers to the accounting systems of the Anglo-Saxon tradition, while balance policy describes the methods embraced by "continental" accounting. The latter type relies primarily on the German approach to recording and valuating economic events, as well as to calculating an entity's goodwill and economic performance. Since the accounting tradition in Poland is more closely related to German accounting rather than the Anglo-Saxon, the term "balance policy" appears to be better suited to describe accounting methods adopted by an economic entity[2].

[2] From this moment on, we shall refer to „accounting policy" only when applicable regulations or source materials use the term. Following Sawicki's definition, „accounting policy" is taken to denote „balance policy".

In addition to the aforementioned ("geographical") distinction proposed by Sawicki, it may be said that "accounting policy" is a wider concept than "balance policy". The reason is that the former covers all "possible" methods, whereas the latter is only concerned with those methods which are sanctioned by the law (Sawicki, 2002, p. 71-83). Consequently, accounting policy may be taken to refer to any trend in modern accounting, while balance policy can only be applied to traditional accounting and accounting engineering.

Still, although we do not mean to question the theoretical distinction put forward by Sawicki, one may say that distinguishing between "accounting policy" and "balance policy" is a purely academic concern. From a practical standpoint, all important distinctions and definitions may be found in the act regulating accounting practice in Poland (*Ustawa…*). The Act uses the term "accounting policy". However, the Accounting Act is, for all intents and purposes, the single most important element of the Polish balance law, which is why it should be assumed that all mentions of "accounting policy" in this Act refer to "balance policy". As we can see, despite any lexicographical controversies, the two terms are seen as synonymous in everyday accounting practice.

Moreover, a "geographical" definition of synonymous terms is at best incomprehensible when considered within the practical accounting framework. This is not to say that there are no differences between "native" German and Anglo-Saxon accounting systems. What matters is the fact that either system is different from the Polish model of accounting, and so distinguishing between "accounting policy" and "balance policy" is largely immaterial. Practical accounting should not be "forced" to define the accounting procedures of one country (with at least a formal jurisprudence in this respect) using a foreign theoretical template. Of course, the underlying condition would require this "supposedly antagonistic" term to be incorporated in the current codified version of the law. Since accounting is a practical science, distinguishing between terms used interchangeably is an unnecessary complication which only encourages tautology. However, to repeat what we have already stated above, this "debate" is purely abstract in nature.

Sawicki singled out a number of conditions which accounting operations need to meet to be part of balance policy. These are:

1) object – balance and performance values of an entity,
2) conformity with codified law – this excludes operations based on common law if a method analogous or similar to the one used by the entity has been codified in law,
3) capacity to make decisions (choose methods) vested in the management board of the entity,
4) possible use of accounting methods chosen by the entity to facilitate the attainment of its economic objectives,
5) intention to influence the recipients of financial statements so as to encourage "behaviour conforming to the entity's expectations" (Sawicki, 1998, p. 69-70).

Jarugowa and Walińska define accounting policy as a component which is essential for the application of financial accounting to corporate structure and whose goal is to "convey an entity's (…) financial position, income and achievements" (Jarugowa and Walińska, 1997, p. 23).

Accounting policy was finally defined within the Polish balance sheet law in 2000. Article 3, section 1, point 11 of the Accounting Act states that the choice of methods according to which assets and financial results are evaluated depends on whether the methods have been codified in the balance sheet law, i.e. whether they are "provided for in the Act". Some accounting researchers attempt to limit the choice by postulating the need to observe so-called "qualitative characteristics (…) of information materiality and credibility" (*ibidem*). However, such an approach is essentially a type of wishful thinking and has little bearing on economic practice. The reason for this is that it questions the statutory freedom of choice granted to economic entities and their right to decide what is material and what is not. This right may only be exercised by the management board. Consequently, those "ideas" produced by accounting theorists and researchers have little practical value for accounting engineering operations unless they are codified in law. This is not to deny that such ideas may prove valuable in creative accounting, which according to some "researchers" should be defined as "accounting fraud".

Brzezin's treatment of accounting policy is somewhat similar to that of Jarugowa and Walińska's. Brzezin additionally postulates that we need to differentiate between micro- and macro-economic aspects of accounting policy and draws our attention to the fact that codified law "prevails" over common law when it comes to prescribing how an accounting system is to function in a given company (Brzezin, 1995, p. 32; Brzezin, 1998, p. 23-26). The distinction between micro- and macro-economic aspects of accounting policy follows from the way it is defined by those who "edit" and "create" it. The management board generates accounting policy an a "micro" level, while governments and intergovernmental bodies are responsible for its "macro" variety.

Brzezin's approach also corresponds to Sawicki's "semantic" interpretation. Not only does the latter emphasize the relations connecting accounting science (theory), accounting policy and accounting practice (Brzezin, 1997, p. 12-13), but also distinguishes two categories of regulations:

1) absolute norms,
2) variant norms (Sawicki, 1996, p. 20 and nexts).

For accounting engineering, the second type is the important one. Norms belonging to this category regulate the character of accounting policy within a given entity (*ibidem*, p. 23).

However, the relations in question concern different levels of the structure and factors responsible for the way it functions. It is therefore not possible to construct a full definition of accounting policy by using Sawicki's or Brzezin's models. The macroeconomic function belongs only to the legislator, who chooses a set of norms from among the ones currently recommended in accounting theory. The microeconomic function, on the other hand, refers to accounting policy *sensu stricto*, as defined in law. Therefore, it becomes important to create a schematic representation of the following relations:

VARIANT ACCOUNTING ← influence of theoretical concepts of accounting
↓
ACCOUNTING IN POLISH ACCOUNTING ACT ← influence of legal regulations
↓
ACCOUNTING POLICY OF COMPANY ← the management board's choice of methods
↓
PRACTICAL ACCOUNTING IN AN ECONOMINC ENTITY

From a theoretical point of view, *accounting engineering*, as structured within accounting policy, may be shown to "fall" between *codified accounting* and the *accounting policy of an entity.* And although Brzezin's model of science-politics-practice may indeed have a considerable "schematic" merit, the relations between accounting micro- and macro-policies correspond only to the relation between the legislator (the law) and the entity observing the law. For practical accounting following the paradigm of accounting engineering, such academic revelations are nothing more than a mere "semantic game".

What is essential for accounting engineering is using the instruments of accounting policy. According to Sawicki's typology of material instruments, the methods which affect the timing of costs recognition are particularly important. These methods deal with certain shifts resulting from adopting an accounting view of economic events. The second relevant material instrument involves using the freedom of choice with respect to valuation methods. Within accounting engineering, the capital structure of a company (following from the value and recognition of the economic effects "generated" by the company) is examined by means of the instruments used to determine its financial results.

As shown by Sawicki and Czubakowska, there exist many impediments to tapping the full potential of balance policy instruments when managing a company (Sawicki and Czubakowska, 1996, p. 331). The same hindrances may be taken to refer to accounting engineering. Notably:

1) consistency principle, which commits entities to use the same accounting methods as before with respect to certain assets (in: Krzywda, 2006, p. 23-37),
2) differences in expectations as regards generating information for various users of financial statements and the accompanying principle that there should only be one original statement,
3) adding footnotes to financial statements in order to make it possible to identify changes in the balance policy of an entity in comparison to prior periods, Polish economic reality permitting amendments to the economic law within the usual accounting period (calendar year).

Accounting engineering offers two dimensions of choice in accounting policy. These are:

1) choice on a horizontal plane – resulting from the influence that operations management exerts on accounting structures,
2) changing the principles of accounting policy; such principles are affected by the prospect of long-term objectives, especially when their end result[3] occurs no earlier than after two reporting periods, starting with the period in which the change is implemented.

It means that the activity will take place in at least one full reporting period whose changes in accounting policy will not be reflected in the entity's financial statements[4].

In this case, the choice involves variant methods which may be implemented into an entity's accounting policy without the need to initiate the whole procedure of change. Such methods take root whenever the „wishful-thinking" reality of the economic process motivates the desire for changes. Accounting engineering shows that it is possible to interpret an „objective economic reality". The availability of choice follows from the premise that the accounting methods that a company adopts are dictated by an „objective" economic reality. This premise is both theoretical and „wishful". To begin with, an „objective economic reality" cannot exist if this „reality" is created by people characterised by different levels of rational behaviour. Additionally, accounting may itself create an „economic reality"; it will not be an „objective" structure (which is not possible), but one that reflects reality. This structure is built by interpreting financial statements drawn up in the accounting engineering paradigm. Accounting engineering operations are, in this respect, subordinate to the economic objective of the entity. The scope of such operations covers the choice of evaluation parameters[5] and evaluation criteria.

According to the „wishful theory" of accounting, such parameters and criteria would always depend on some „objective external circumstances". Since the „interpretation" of these „circumstances" is

[3] An accounting treatment of strategic objectives necessitates the use of partial (when an accounting period ends) and final solutions (when operations end). This is reflected in the way prepayments, accruals and provisions are calculated.
[4] Following point 5, sub-point 3 of *Footnotes to financial statements* and in connection to point 5 thereof
[5] Most importantly: (1) purchase cost, (2) production cost, (3) net selling price, (4) fair value, (5) market value, (6) receivable payment, (7) nominal value.

done by the company (more precisely, its management board), it is the company that decides which operations are applicable in a given situation. All this demonstrates that the codified theory of variant accounting has rendered absurd the description and evaluation of economic events. The absurdity of the situation lies in the fact that those elements which are meant to be objective (financial statements) are determined by those elements which are in fact subjective (an entity's management).

Accounting policy of a company is drawn up as a written document, and it is required that any changes to the principles of this policy be made in writing. Legal regulations allow economic entities to "amend" their accounting policies in specific circumstances[6]. As seen by a company, some reasons may appear to be objective in character, e.g. changes in current legal regulations (changes in accounting macro-policy, according to Brzezin); still, they may also be effected on the management board's own initiative. Here are some of the changes permitted by IAS 8:

1) changes resulting from alterations of the company's articles,
2) changes which, in the company's own opinion, offer „a better view of events and transactions in financial statements of a given economic entity".

The first category refers directly to operations management; the second one calls for long-term solutions involving two subsequent reporting periods. In the first case, the decision is made by the entity's owners; in the second, by those who manage it.

Implementing the accounting policies of an entity generates economic information about that entity contained in its financial statements. Consequently, the following aspects are affected by accounting policy:

1) scope of released information,
2) structure and *modus operandi* of accounting in the entity.

Conclusions

Examining accounting policies of an entity from the theoretical perspective of accounting engineering reveals that accounting policy is the hub of many manipulative practices. If a company is given a free hand to choose its accounting methods, it may adjust them in such a way as to achieve the most desirable financial results. This allows the management board to interfere, without violating the balance sheet law, with the financial information about its company. At the same time, the influence of accounting engineering on financial results is not taken into account by those who review financial statements (auditors), which causes them to accept statements which afford no real opportunity to assess the management's efficiency, effectively preventing potential shareholders from assessing the efficiency of their possible investments.

Therefore, the influence of accounting engineering on financial results calls for further research, which should aim to establish the ratio of "influence of accounting methods" on financial results. Only with such a ratio at our disposal would we be able to compare two different financial statements drawn up by two distinct economic entities using disparate accounting methods as part of their accounting policies.

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[6] *Cf.* article 8 of the Polish Accounting Act, and IAS 8

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