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Fiscal Pedal: Fraud or Creative Accounting? A Theoretical Understanding of the Dangerous Fiscal Cycles that Affected the Brazilian Economy

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Abstract

This essay aims to discuss, in a theoretical way, how creative accounting is presented in Brazil in the years 2014 and 2015, which resulted in an impeachment process and affected the Brazilian economy. The methodology is qualitative with the application of content and document analysis techniques. The basis of the accounting information is taken from the analyzes of the special impeachment commission and the Federal Court of Auditors in relation to the accusation of a crime of fiscal responsibility to the detriment of the president of the republic. The research discusses the accounting operations carried out by the government and which resulted in the famous expression “fiscal pedaling”. In light of accounting theory Hendriksen and Van Breda (2018), there is a complexity in the analysis that has led to frequent divergences regarding the objectives of accounting and the nature of the economic environment in which it operates. Thus, as research results, it is possible to observe that the concepts given to creative accounting and fraud are close, but they are not similar, where characteristics such as intentional error and the transit of accounting operations, outside the accounting regulations and principles, end up elucidating the particularities of each phenomenon.

Keywords: accounting theory, creative accounting, fraud, public finances, tax cycling

1. Introduction

Administration is the most evident form of government action, where on one side there is the State and on the other society, which demands public goods and services and has increasingly participated in the conduct of administration through public opinion (Wilson, 1946) .

Economic crises motivate an immediate response from public agents to society. Especially when there are corruption scandals involving the people’s representatives. At the beginning of the 1990s, numerous reports of misappropriation of public resources and acts of administrative improbity emerged in Brazil, which resulted in the 1992 presidential impeachment.

Economic globalization, debt and the requirement for transparency from international financial organizations were part of the scenario that motivated the social outcry for the moralization of Brazilian public administration during the 1990s. It is in this context that Complementary Law No. 101, called of the Fiscal Responsibility Law (LRF), which began to establish a responsible fiscal management regime for all spheres of government and for each of its powers.

The LRF was mirrored in other international standards that legislated on public spending and that emerged with the mission of correcting problems similar to what Brazil was experiencing in the 90s, with a fiscal crisis, growing primary deficit and political crisis. Thus, the Standard emerges as a pillar for improving Brazilian public management (Nascimento & Debus, 2002; Toledo Júnior & Rossi, 2005).

According to Khair (2000), it not only brings about an institutional and cultural change in dealing with public money, but also gives hope for better days for a society devastated by its historical and endless cases of corruption, with the result that there is no longer any tolerance. and impunity for those who irresponsibly manage public money.

More recently, the quality of public spending has also become the focus of technical and academic studies in public administration. It is not enough to execute public expenditure legally, other guiding principles of good public administration have also come to have more emphasis on management, such as efficiency and effectiveness. In this sense, Complementary Bill 220/2009 is being processed, already approved by the Federal Senate, which establishes the New Public Finance Law or Fiscal Quality Law, which improves financial standards aimed at public budgeting, control and public accounting.

For many experts, the economic crisis that affected Brazil in 2014 and which generated a major recession for the following two financial years, was one of the biggest ever seen in the country. The economic crisis, which was accompanied by a political crisis that resulted in a new impeachment process, had devastating results for the Brazilian economy.

For Firmage and Mangrum (1974), the impeachment process is a slow and unjustifiably expensive process, in which congress expresses its will, causing distress in an electorate exhausted by duties not fulfilled by the government. Furthermore, the process has a political nature, as the concern is not to protect the State from crimes caused by the public agent, but to deprive the accused of their political rights.

In this sense, this article is motivated by the authors' concern with the semantic confusion that has arisen between fraud and creativity in accounting. The study does not seek to address the impeachment process, nor the country's political issues. The objective is to debate the accounting procedure prohibited by the standard and which provided the basis for accepting the crime report and resulting in the popularization of the expression "tax pedals".

The famous tax cycles were operations carried out by the government through the National Treasury Secretariat, which is mentioned several times in the reports of the Federal Audit Court (TCU) and the Special Impeachment Commission (CEI). So, are these tax maneuvers that resulted in operations that are prohibited by Brazilian legislation a form of creative accounting or fraud? In other words, is fiscal pedaling fraud or creative accounting?

Among the operations characterized as fiscal pedaling and which are prohibited by the LRF, art. 36 which establishes the rule that it is not possible for a federation entity to carry out credit operations with a state financial institution controlled by it. The rule is justified to prevent the entity from using the financial institution it controls to finance its expenses, avoiding creative tax accounting.

Failure to comply with this rule led to the rejection of the presidential accounts by the Federal Audit Court and culminated in the crime being reported to the National Congress and the opening of a Special Commission responsible for analyzing the facts and determining whether there was a crime of fiscal responsibility.

In fact, in addition to a rigid budget, Brazil has complex public accounting with several stages, with the control stage being highlighted in accounting entries precisely because it seeks to highlight what is projected and what is executed. For this balance to occur, management must observe several regulations, among them the LRF brings rigidity in the execution of public expenditure, seeking responsible fiscal management (Iudícibus, 2021; Milesi-Ferretti, 2004).

The rigidity of the standard ends up motivating managers to seek other ways of executing their plans, however, these solutions are not always aligned with the rules and violating the rules presupposes creative accounting. It should be noted that the intention in omitting or distorting accounting information, which may cause those interested in this information to change their judgment or decision, ends up presenting characteristics of a fraudulent action (Dechow & Douglas, 2000; Milesi-Ferretti, 2004).

This article, of a qualitative nature, contributes to the literature by exploring, in the light of accounting theory, the analyzes of the special impeachment committee and the Federal Court of Auditors in relation to the accusation of a crime of fiscal responsibility to the detriment of the president of the republic, which resulted in the popularization of the expression "fiscal pedaling".

Finally, in addition to this introductory chapter, this study was divided into three more topics. The second provides the theoretical framework in which the concepts of fraud and creative accounting are addressed. The third presents the analysis of the CEI and TCU reports in relation to crime reporting. The fourth chapter brings final considerations and suggestions for future studies.

2. Theoretical Framework

Pierson (2000) highlights that it is increasingly common for social scientists to describe political processes as "path dependence", which is related to the new institutionalism and which is treated in politics as a situation in which the agent's choice is shaped or directed by institutional paths of choices made in the past. For the author, political development is accentuated by critical moments or economic situations that end up affecting the life of society.

Thus, it is possible to observe the behavioral changes of individuals through neglect of the social context and the durability of agents in power. The durability of social life also began to impact institutions, as demographic issues end up increasing the cost of institutions, not only because they become larger, but also because they become even more complex. (Powell & Dimaggio, 1991).

For Powell and Dimaggio (1991), individuals seek to maximize their behavior in relation to stable and consistent preference orders. Thus, it is possible that this behavioral maximization is due to cognitive limit issues, incomplete information or difficulties in monitoring and enforcing agreements, however some people behave in an opportunistic manner and end up interfering with rationality.

The growth of the State and consequently of public spending ends up requiring better control mechanisms. This includes improving public agent accountability and public transparency, so that users of accounting information (taxpayers, control bodies, legislative branches, financial institutions, etc.) can monitor management and make decisions.

Hendriksen and Van Breda (2018) elucidate that there is a complexity in the analysis that has led to frequent divergences regarding the objectives of accounting and the nature of the economic environment in which it operates. For Iud ́cibus (2021), establishing the objective is the starting point for studying the theory of a social science such as accounting, with the formulation of objectives transcending principles and norms, as these are only the conceptual means to achieve the objectives. goals.

For Iud ́cibus (2021), the public accounting model adopted in Brazil is highly complex and time-consuming, given the various stages that involve accounting entries, such as the control stage that aims to evaluate goals and achievements, with the focus on deviations.

Unlike private sector entities that aim to make profits and generate financial returns for investors, the objective of public sector entities is to provide services to society. The public budget is the basis for the government to define the levels of taxation and other revenues and propose public spending. It is through transparency in the execution of the public budget that society can monitor and analyze the performance of public sector entities, by comparing budget execution information with the expected budget (CFC, 2016a).

Accountability and accountability are assessed and judged by the legislative branch. Furthermore, transparent reporting ends up providing support for the decision-making process regarding budgets for subsequent years. The NBC TSP CONCEPTUAL STRUCTURE provides that: "The preparation of a statement that presents and compares the execution of the budget with the expected budget is the mechanism normally used to demonstrate compliance with legal requirements relating to public finances." (CFC, p. 6, 2016).

Al-sharif et al. (2017) understand that creativity has a positive connotation, but that creative accounting has been constantly associated with negative fraudulent practices. However, creative accounting, which is a practice where accountants use their knowledge of accounting rules to manipulate numbers, cannot be confused with the concepts and characteristics of fraud.

Therefore, it is important to bring concepts of creative accounting and fraud, so that we can better understand the expression "fiscal pedaling" and answer a question that has been debated not only in the field of accounting sciences, but in public administration, economics and law: Is tax pedaling creative accounting or fraud?

2.1 Creative Accounting

Creativity, which in many areas is seen favorably, as it is an act of innovating, of bringing ideas that can change something, of improving techniques and perfecting skills, is not perceived in accounting with the same lens when approaching the term "creative accounting". Creative accounting is seen as an intentional accounting practice that violates rules with the aim of making up accounting accounts and disguising the reality of the accounts.

Jones (2010, p. 6) defines creative accounting as a way of using accounting, within regulations, to present accounts, prioritizing the interests of preparers and not users.

Milesi-Ferretti (2004) presents a model that studies the effects of a budgetary rule on fiscal policy. Fiscal rules have been debated for several years and during the second half of the 1990s it was the center of attention due to fiscal deficits and public debt in European Union countries. For the author, these rules can lead to three results: good ones (which induce governments that spend excessively to engage in virtuous fiscal behavior); the bad ones (which make it difficult to use a countercyclical fiscal policy and end up hindering government actions) and the unpleasant ones (a lot of creative accounting and little overall effect on fiscal policy).

Santolin, Jayme and Dos Reis (2009) understand that, in an environment of macroeconomic depression, establishing rigid rules and severe punishments end up limiting spending to reach fiscal limits, especially investment spending that has greater flexibility in its change. compared to other expenses that have a more rigid structure.

This rigidity is what motivates the violation of the rule and consequently the motivation for creative accounting, because as there is a rigidity in the form of changing expenses, the manager ends up looking for alternatives to execute the expense within the fiscal limits, building an accounting makeup that can come to mask the reality of public accounts.

Milesi-Ferretti (2004) shares the understanding that creative accounting presupposes the violation of rules. This violation imposes costs on both the government and the public, where a country that does not comply with the fiscal rule has to be punished in some way, whether through a financial penalty or another form of cost such as exclusion from an external financial assistance program. Yadav (2013) explains that creative accounting is the use of accounting knowledge to present numbers within accounting standards and laws, without demonstrating the real performance or position of the entity. Therefore, the intention is to provide the information that interested parties want.

The moralization of public administration is a desire of society and several norms emerge with the aim of providing this guarantee to society. However, it is not enough to just publish a standard, it must be complied with. The LRF establishes rules aimed at the responsibility of public management in Brazil and its provisions were inspired by international regulations, which involve actions aimed at planning, transparency, risk prevention and correction of deviations that are capable of affecting the balance of public accounts.

Milesi-Ferretti (2004) elucidate that even if society demands a balanced budget, the development of a more rigid standard ends up encouraging creative accounting and increasing the risk of violating the rule. For Milesi-Ferretti (2004), if the intention is to reduce creative accounting, the appropriate tool for this is not the rigidity of the Law, but an increase in the degree of transparency.

LRF creates strict rules to encourage fiscal responsibility, avoid imbalance in public accounts and indebtedness of federation entities and their powers. It was through the LRF that the government established several limits for public spending, in addition to complementary objectives such as broad transparency in the procedures for collecting and applying public resources (Santolin et al., 2009; Niyama & Tibúrcio Silva, 2021).

The LRF ends up improving the responsibility of fiscal management through the influence it exerts on financial and budgetary execution in public administration, but, despite the several positive points that the standard brought, it cannot be said that it is an innovation in public accounting (Niyama & Tibúrcio Silva, 2021).

For Dalmonech et al. (2011) the LRF is a legal instrument that highlights the application of the economic model of bureaucracy (Niskanian), which, in the face of scarce resources, establishes responsibilities, objectives and goals for the public manager. Sacramento (2015) shares this understanding and adds that the LRF was decisive for the advancement of accountability in Brazil. For this author, the supervision of the rule by the legislative branch, with the assistance of the audit courts and the limitation of the authority of the executive branch through its budgetary plans, corroborate aspects of horizontal and vertical controls. Furthermore, issues related to answerability and enforcement, addressed by Schedler et al. (1999), are reinforced through the publication of reports, public hearings and the application of penalties to those who fail to comply with the rules.

It should be noted that the rigidity of the rule cannot be understood as a mathematical equation, for example, when obliging managers to keep public accounts balanced, the rule does not require that the numerical difference between revenues and expenses be equal to zero, but rather that this equation makes it possible to obtain stable and balanced values, making it possible to prove that there are sufficient resources to carry out the expenses. The goals that are established in budget planning are in the same way, in the sense that there must be an approximation between what was programmed and what was executed, precisely to avoid the elaboration of superficial plans and unattainable goals, common practices in years prior to promulgation of the LRF (Abraham 2021).

2.2 Fraud

For Jones (2010, p. 6), fraud is an alteration of the truth or the concealment of a material fact that induces a person to act to their detriment. NBC TA 240, which correlates with ISA 240, distinguishes fraud from error through intent. The intentional action that results in distortions of the financial statements is characteristic of fraud (CFC, 2016b).

Rose-Ackerman and Palifka (2020, p. 25) share this understanding that accounting fraud presupposes a purposeful error. The authors explain that public service fraud is "any activity that undermines the legal requirements for the provision of public services, even if no bribe is paid".

Al-sharif et al. (2017) also understand that the existence of accounting fraud requires a departure from the rules. However, care must be taken when trying to distinguish fraud from creative accounting, as it can give the impression that fraud is bad and creative accounting is intelligent, when, in fact, both bring distortions to the statements and compromise the information made available to users.

Therefore, it is observed that the literature highlights two basic characteristics for fraud: intention and departure from the rules. However, Jones (2010) reminds us that fraud is also related to fictitious accounting operations that are prohibited by generally accepted accounting principles and is not just about non-compliance with legislative rules.

Baralexis (2004) presents a study on the problems of creative accounting in Greece. The study shows that creative accounting is practiced in Greece with a certain frequency, where there is not only the exploitation of weaknesses in the Law and generally accepted accounting principles, but also a violation of these rules. This violation of the rules ends up directing accounting into the field of intentional distortion or omission, which are characteristics of fraud.

Finally, in developing countries, accounting ends up being a tool for modernizing financial management and reduces opportunities for fraud and waste of public money (Torres, 2004). Public accounting, being even more complex than private accounting, requires control mechanisms that end up providing greater transparency in relation to what was projected for expenditure and what was actually executed. For control bodies, this controlled execution ends up benefiting the assessment of compliance in accountability.

3. Methodology

The study database is made up of the Accounts Report of the Government of the Republic: Financial Year 2015 (TCU, 2015) and the Report of the Special Impeachment Commission (CEI) (BRAZIL, 2016). The first is a document prepared by the Federal Audit Court (TCU) that issues a prior opinion on government accounts, with the purpose of supporting the political judgment carried out by the National Congress. The second report is a document prepared by a special committee formed in the Brazilian Senate, which aims to analyze the admissibility of the Impeachment process in accordance with the authorization of the Chamber of Deputies.

The Report of the Special Impeachment Commission (CEI) (BRAZIL, 2016) is an extensive document with 441 pages that summarizes the analysis of several other documents that were received to investigate the process. The Accounts Report of the Government of the Republic: Financial Year 2015 (TCU, 2015) is a brief instrument, but has 14 annexes that involve appendices and summary sheets with information on budget execution and pointing out irregularities by the court of accounts.

Data analysis is qualitative, as it does not include counting or measurements. Content and document analysis were the techniques used to process the data, seeking to explore the semantic confusion that was established between fraud and creativity in accounting, comparing the data collected through TCU and CEI reports with theoretical concepts on the subject.

One of the purposes of qualitative analysis is to find patterns and reproduce explanations. This analysis is guided by pre-existing ideas and concepts that direct the researcher to deduce particular explanations from general theories. Therefore, there is a tendency to consider qualitative research as constructivist, as it is related to the interpretation of new explanations about unique attributes of individual cases (Gibbs & Flick, 2009).

For Stemler (2000), content analysis is useful for examining trends and patterns in documents, providing an empirical basis for monitoring changes in public opinion. Bowen (2009) explains that document analysis is a systematic procedure for reviewing or evaluating documents, but the method requires that data be examined and interpreted to obtain meaning and develop empirical knowledge.

4. Analysis and Discussion

The word impeachment has its etymological origin, from the Latin impedimentum , which means to prevent or prohibit entry with the feet. Etymologically the idea of the word impeachment would be “the prohibition of entry”. In English, due to the natural evolution of the meaning of the word, the verb to Impeach has the meaning of accusing, incriminating with the purpose of stopping the criminal individual (Riccitelli, 2006).

Impeachment ends up targeting those individuals who hold high positions and who act against the public interest. In a democratic State based on the rule of law, it would be like a betrayal of the people who chose a certain individual, voluntarily, to represent them.

The Magna Carta establishes that the legislative power is responsible for conducting the process that sanctions the conduct of the public authority subject to removal from office and application of the penalty. In short, to understand the procedural flow of impeachment in Brazil, it is up to the president of the Chamber of Deputies to receive the complaint, present it to the plenary, create a commission for analysis and notify the public authority reported about acceptance of the complaint. After the work of the chamber committee has been carried out, the opinion goes to the plenary for voting, requiring the vote of 2/3 of the deputies to authorize the opening of the impeachment process and subsequent sending to the Federal Senate to conduct the process. In the Senate, the Special Impeachment Commission was created, which will analyze the legal requirements necessary for the admissibility of the complaint.

The accusation of a crime to the detriment of the president of the republic that resulted in the 2016 impeachment, is related to the crimes of fiscal responsibility established by the LRF, specifically, to the provisions of article 36 “The credit operation between a state financial institution and the entity of the Federation that controls it, as beneficiary of the loan.”

Failure to comply with article 36 of the LRF constitutes a crime of responsibility. The “crime” nomenclature for non-compliance with the standard ends up associating the accounting operation with fraud. However, there is no sanction characteristic of criminal offenses in crimes of responsibility. These crimes are more conduct of functional responsibility than a crime. Thus, liability crime and common crime are not legal figures with the same concepts (Brasil, 2016).

Therefore, the understanding of the TCU and the CEI was that there was non-compliance with article 36 of the LRF and, consequently, the crime of fiscal responsibility was characterized, with impeachment being a horizontal control mechanism for the practice of crimes by the Presidency of the Republic.

That said, the famous fiscal pedaling was pointed out by the court of accounts in 2014, when contested credit operations allowed the federal public debt to be undersized, as can be seen in Figure 1 below:

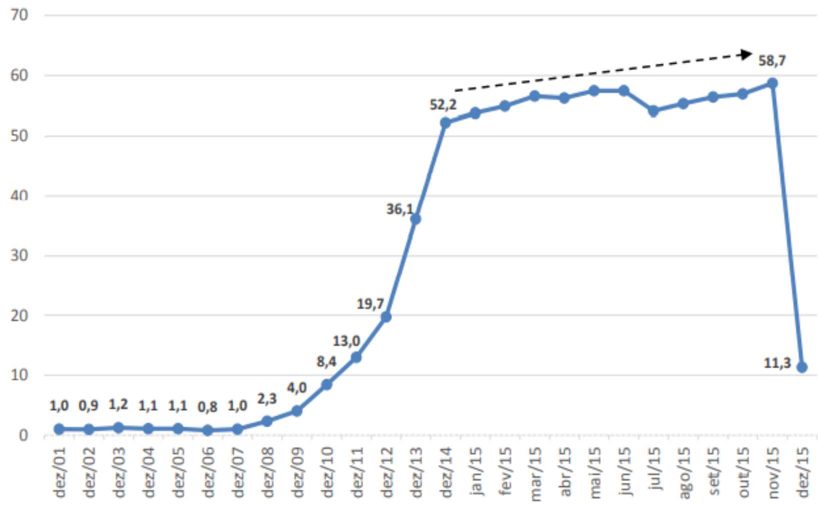

Figure 1. Union lLiabilities with BB, BNDES, CAIXA AND FGTS (R$ billion)

Note. Report of the Special Impeachment Commission (CEI) (Brazil 2016).

It is observed that from 2008 onwards there was a considerable increase in the Union’s liabilities, rising from amounts close to R$ 2 billion and reaching R$ 52 billion in 2014. In 2015, liabilities continued to rise and reached the amount of R$ 58 billion, and this evolution is not new facts, but only the repetition and worsening of the irregular practice was already questioned by the TCU in 2014.

The same accounting maneuver ended up also resulting in makeup in the primary results. Figure 2 shows that the 2015 fiscal performance maintains similarities with the 2015 fiscal year, but is more critical, considering that the primary result target was R$ 55.3 billion and at the end of the year the result was a deficit of R$ 116.7 billion.

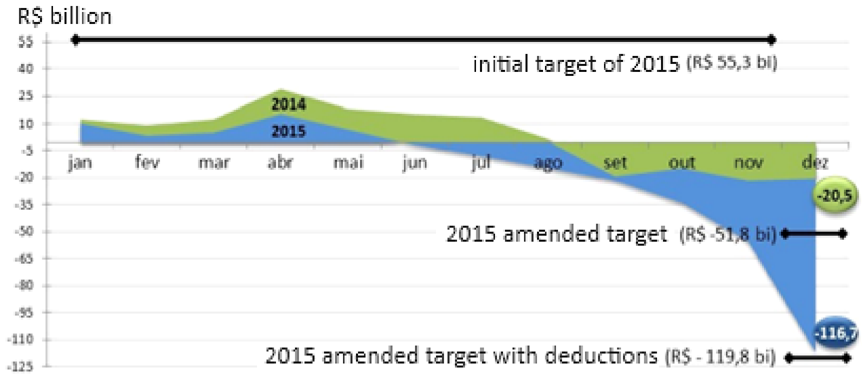

Figure 2. Accumulated Primary Result for the year (2014 versus 2015)

Note. Report of the Special Impeachment Commission (CEI) (Brazil 2016).

The TCU warned of a fiscal paradox, in which the country was experiencing a sequence of revenue frustrations and, at the same time, encouraged the expansion of public spending as if there was excess revenue. This government action is explained by Milesi-Ferretti (2004), in which the rigidity of the LRF, which began to demand responsible and balanced management, with goals that were established in the budget plan and that could be achieved, ended up causing a departure creative approach to present satisfactory fiscal results to society.

Thus, in the light of accounting theory, it is possible to observe that the accounting operations that ended up generating fiscal results incompatible with reality and that resulted in the expression " fiscal pedaling" cannot be considered just creative accounting, as they resulted in a makeup of financial statements to serve the interests of preparers and not users.

Jones (2010) explains that creative accounting is a way of using accounting within regulations and what can be observed in the accounting operations carried out by the government in the years 2014 and 2015 is that they were carried out outside the fiscal rules and, therefore, , now have the characteristics of fraud, as they are more aligned with the concepts of tax crimes, which involve an intentional act (or purposeful error), which alters the truth, misleads the user of accounting information and goes outside the current accounting regulations, characteristics highlighted by Jones (2010), Rose-Ackerman and Palifka (2020) and Al-sharif et al. (2017).

5. Final Considerations

The research results that creative accounting appears to have characteristics very similar to fraud. However, the intentional issue of error and the movement of accounting operations outside the accounting regulations and principles end up making it clearer which position each person falls into. Thus, research sought to bring contributions to the debate on the topic, which is sensitive when discussed by society, but which can be explored and explained through social science theories. Effective collaboration occurs through the elucidation of the distinction between the concepts between fraud and creativity in accounting, as well as ratifying the statements of previously existing studies on the topic.

Accounting operations that generated tax results that are incompatible with reality, move away from the characteristics of creative accounting defined by Jones (2010) as that accounting used within regulations and are closer to fraud, given the alteration of the truth or the concealment of a material fact, on purpose, that induces a person to act to their detriment, as stated by Jones (2010) and Rose-Ackerman and Palifka (2020).

Therefore, it is observed that accounting theory can contribute to the explanation of these events, including facilitating the legal basis in criminal proceedings, given that the execution of the government plan involves faithful compliance with budget plans that are published by means of Law and that follow the rules focused on public accounting.

Furthermore, it is nothing new for public agents to seek simple solutions to complex problems. Accounting creativity ends up being a powerful tool for managers to disguise their results in favor of particular benefits. Ostrom and Ostrom (2004) already warned of problems like these, when decision makers often make political decisions within the restrictions of a set of collective choice rules. These decisions end up impacting the eligibility of the agent who participates in policy formulation or prepares the rules that will be used to formulate policies. The intention of the public agent is not the balance of public accounts, which became a duty imposed by the LRF, but rather his perpetuation in power.

It should be noted that other theories can shed light on the understanding of concepts involving fraud, creative accounting, intentional error, irregularity, tax crime, etc., such as agency theory, which is widely explored in the field of accounting science and public administration. and is concerned with resolving problems of conflict of interests between the objectives of the principal and the agent, as well as the neo-institutionalist theory that can explain the behavior of rulers who seek to maximize their private interests.

It is also noteworthy that the theory, aligned with the technical understandings of the TCU and the CEI, strengthens the characteristics of a crime of fiscal responsibility, as well as the descriptive statistics presented in the reports provide clarity and ratify the non-compliance with article 36 of the LRF, proving that the theory of checks and balances and the horizontal control mechanism in Brazil ensure a social purpose.

Finally, this work does not exhaust the debate on creative accounting versus fraud, but explores these concepts that are constantly related to tax cycles. Therefore, it is necessary to expand the study through other academic references that can contribute to the theoretical debate on creative accounting and fraud, as well as suggesting studies focused on recent fiscal pedaling practices adopted by federal and state governments. and municipal.

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