



Ethical Challenges of Creative Accounting Practices in Nigeria

K. A. Yahaya

Department of Accounting, Faculty of Management Sciences, University of Ilorin, Ilorin, Nigeria.

ABSTRACT

This study is an empirical investigation into creative accounting practices in Nigeria. It examines the debilitating effects of the practices on the truthfulness and fairness of financial statement and the quality of investment decisions. It also investigates the various motivations behind the practices, ranging from undue upward movement in share prices to improvement of debt rating, reduction of cost of borrowing, boosting of profit-based bonuses and avoidance of high taxes. The population comprised firms of chartered accountants and accountants in academic. The sample consisted of one hundred and ten respondents (accountants). The major instrument used for generating the data was a questionnaire, which was designed based on a five-response option of Likert type scale. The data generated were analyzed through Generalized Least Square Technique (GLST). The study revealed that creative accounting practices have adverse effects on the quality of financial information. Based on the findings, it was recommended that corporate institutions should comply with the new International Financial Reporting Standard in order to reduce creative accounting practices. The introduction of punitive measures could also assist in curbing the act of creative accounting in Nigeria.

Keywords: Auditing, Creative Accounting, Forensic Accounting, International Financial Reporting Standards.

INTRODUCTION

The main objective of financial reporting is to provide information about the wealth performance and financial health of a company. Though it is true that financial statements are likely to be the most effective way of conveying information to the public, it should be noted that when reading the reports; the figures may not necessarily show a true and fair view and might also be misleading (Ibanichuka & Ihendinihu, 2012). However, the accounting process and regulatory framework prescribed by the different regulatory agencies in the accounting profession give room for discretionary judgments by the accountants. Trying to resolve conflicts between the competing different approaches in which the results of financial events and transactions are presented, provides opportunity for manipulation, deceit, and misrepresentation (Balaciu & Pop, 2014). These negative practices by the less scrupulous elements of the accounting profession are popularly known as Creative Accounting. Creative accounting at an individual entity level involves preparers altering accounting disclosures so as to create the view of reality that they wish to communicate to users of financial statements. This type of behaviour is described as micro-manipulation (Amat & Gowthorpe, 2004) and it is also called creative accounting in the UK, and earnings management in the US (Ezeani, Ogbonna, Ezemoyih & Okonye, 2012).

Statement of the Problem

Creative Accounting has become a topical and current issue of late, particularly since the collapse of Enron and other companies like WorldCom, Tyco, Xerox, and HealthSouth in the U.S. and those in Europe like Ahold, Vivendi, Lernout and Hauspie (Ibanichuka & Ihendinihu, 2012). Nigeria is not left out from the growing wave of financial scandal and fraud. The collapse of Savanna bank and African

*Corresponding Author: Khadijat Adenola Yahaya, +2348056664707, yakhadijat@unilorin.edu.ng or khadijatadenola@yahoo.com

International Bank (AIB), overstatement of Cadbury's account between ₦13 billion to ₦15 billion over a number of years, accounts manipulation in African Petroleum (AP) and the five chief executive officers of Nigerian banks that were sacked by the Central Bank of Nigeria (CBN) have been linked to creative accounting practices (Odia & Ogiedu, 2013). Specifically, it is clear that the board and top management of Cadbury (Nig) Plc allowed self interest and sheer greed to come between them and their primary duty of creating value for shareholders. Most of these scandals were as a result of non-compliance with cooperate governance code in presenting the financial reports (Okaro & Okafor, 2009). The problem of this study is that the debilitating effects of creative accounting practices on the truthfulness and fairness of financial reports and hence the users of accounting information and their investment decision making effectiveness become threatened day by day. Also, the challenge of creative accounting goes to the heart of business regulation, business ethics and other fields. This study therefore examines creative accounting practices as a whole, including the issues and formidable challenges it offers to the accounting profession and the various possible ways in which the practice can be detected and prevented.

Research Questions

Based on the research problems, the following research questions were raised:

- i. Can the adoption of international financial reporting standards, prevent the occurrence of creative accounting practices in Nigeria?
- ii. Is there a relationship between auditing practices of companies and the detection of creative accounting practices in Nigeria?

Objectives of the Study

The main objective of this study is to examine the issues and challenges of creative accounting as it affects corporate financial reporting in Nigeria. While, the specific objectives are to;

- i. evaluate the effect of international financial reporting standards on the prevention of creative accounting practices; and
- ii. investigate the effectiveness of auditing practices of companies in detecting the practices of creative accounting.

Research Hypotheses

In order to provide solution to the research problems identified above and to achieve the purpose of this study, the following hypotheses stated in their null form were developed and tested empirically:

- Ho₁: The adoption of international financial reporting standards does not have significant influence on the prevention of creative accounting practices.
- Ho₂: There is no significant relationship between auditing practices and the detection of creative accounting practices.

Conceptual Framework

Basic idea of creative accounting

Susmus & Demirhan (2013) defined account manipulation as an ability to increase or decrease reported net income at will. Stolowy and Breton (2000) developed a framework classifying the activities of accounts manipulation in relationship with the two aspects of risk (systematic risk and financial risk) and categorized these activities as earnings management and creative accounting. But many researchers in the literature used them synonymously. Creative accounting is the more preferred term in Europe, whereas it more common to use earnings management in the US (Amat & Gowthorpe, 2004). However, the term "Creative Accounting" first originated with the movie "The Producers" by Mel Brooks in 1968. In this movie, the producers of a play deceived the backers of their play by selling many times over the total value of the enterprise based on the assumption that the play would be unsuccessful and that the backers would expect no financial gain and the producers would make ill-gotten profit. However, the play became very successful surprisingly, creating a

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Griffiths (1986) writing from the perspective of a business journalist, describes creative accounting in the following words:

Every company in the country is fiddling its profits. Every set of published account is based on books which have been gently cooked or completely roasted. The figures which are fed twice a year to the investing public have all been changed in order to protect the guilty. It is the biggest con trick since the Trojan horse ... In fact; this deception is all in perfectly good taste. It is totally legitimate. It is creative accounting (p. 1).

Jameson (1988), writing from the perspective of the accountant argues that:

The accounting process consists of dealing with many matters of judgment and of resolving conflicts between competing approaches to the presentation of the results of financial event sand transactions ... this flexibility provides opportunities for manipulations, deceit, and misrepresentation. These activities practiced by the less scrupulous elements of the accounting profession have come to be known as creative accounting (p. 8).

Based on his experience, Terry Smith (1992) reports as an investment analyst that "we felt that much of the apparent growth in profits which had occurred in the 1980s was the result of accounting sleight of hand rather than genuine economic growth, and we set out to expose the main techniques involved, and to give live examples of companies using those techniques".

Naser (1993), presenting an academic's view, defined Creative Accounting as the transformation of financial accounting figures from what they actually are to what preparers desire by taking advantage of the existing rules and/or ignoring some or all of them.

The opinions expressed by the authors actually have two features in common, which is observed by Naser (1993):

- i. They perceive the incidence of creative accounting to be common.
- ii. They see creative accounting as a deceitful and undesirable practice.

Several methods can be followed to practice creative accounting, all of which can be categorized into four groups as follows:

- i. The selection among different available accounting methods.
- ii. The existence of estimation, judgment, and prediction in the financial statements.
- iii. The artificial transaction that can be made to manipulate the amounts of the balance sheet or move profits between the accounting periods.
- iv. The genuine transactions which can be timed to express the desired impression in the accounts (Amat, Blake, and Dowds (1999).

Motivation for creative accounting

Various research studies have examined the issue of management motivation towards creative accounting behaviour. According to Hepworth (1953), several motivations including the existence of tax levies are based on income, confidence by shareholders and workers in management that is able to report stable earnings and psychological expectations relating to increases or decreases in anticipated income. Amat, Blake and Dowds (1999) list the following as part of the reasons managers and accountants engage in creative accounting practices:

- i. Income Smoothing: This method is used to mitigate variations of profit characterized by its increases and decreases, by providing an image showing a profit with a growing trend. This method assumes that during a year an economic entity records good results. It should establish – actually unnecessary – provisions higher than the value of assets in order to use them to “smoothen” profit during years when profit is declining.
- ii. Comply with the limits included in predictions.
- iii. Creative accounting may help to maintain or increase share price by artificially creating a positive profit trend, helping the economic entity gain capital from the issue of new shares and resist other economic entities’ attempt to take over the entire economic entity.

Jones (2011) made the following classifications in relation to the reasons for resorting to creative accounting:

- i. Personal incentives – granting certain bonuses, salary increases, job security, personal satisfaction;
- ii. External expectations – analysts’ expectations achievement, turning profits, employment in existing rules;
- iii. Special circumstances – new issues of shares, loans management, mergers and acquisitions, new management team, waiting for better times; and
- iv. Covering fraud – misappropriation of assets.

Taxation can be seen as a major motivator for creative accounting. High-profile firms may be motivated to manage their earnings downward in an effort to be less attractive to regulators and thus less likely to incur high taxation expenditure. According to Hale (1988), creative accounting has been seen as a way to escape from government expenditure controls. Tax is also a significant motivator (Ezeani, Ogbonna, Ezemoyih and Okonye 2012) in a Finnish context and in Japan (Kamau, Mutiso & Nguu 1996). Earnings-based compensation can also make managers apply earning management techniques. Managers can engage in earnings management to just meet an earnings benchmark to increase job security or bonuses (Gunny, 2010).

Theoretical Framework

Agency theory

The theoretical framework adopted in this study is the Agency Theory. This theory seeks to ensure that agents (executives, managers) act in the best interests of the principals (owners, shareholders) of an organization. Agency theory addresses the relationship where in a contract ‘one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent’ (Jensen and Meckling, 1976). This happens because of the separation of ownership and control, when the owner of the company or the board of directors (the ‘principals’) have to employ managers (‘agents’) to run the business and to monitor their performance in order to ensure they act in the owner’s interest. The main concern of agency theory as proposed by Jensen and Meckling (1976) is how to write contracts in which an agent’s performance can be measured and incentivized so that they act with the principal’s interests in mind. Based on the idea that employees (at any level) will have diverse goals, two main agency problems are identified which are: how to align the conflicting goals of principals and agents, and how to ensure agents perform in the way principals expect them to. These problems can occur when executives or managers make self interested decisions and manipulate information on performance, perhaps by moving numbers around or by ‘creative accounting’ to present better performance figures. The solution to either of these agency problems is to ensure that executives or managers act in the best interests of the owners by increasing the amount and quality of information available to principals and making senior executives part owners of the firm through their compensation packages. The relevance of the agency theory to this study is that accountants at times collaborate with the management either to increase (inflate) or decrease (deflate) the financial statement. Accountants instead of rendering the

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According to Mulford and Comiskey (2002), International Financial Reporting Standards (IFRS) 1 titled 'The Financial Statements' Reporting ' is a standard that deals with the order to bring out and to present the right financial information. Hence, the following conditions have to be taken into account;

- The concordance with international financial reporting standard stipulations;
- The possibility to depart from international financial reporting standards, if according to the stipulation, the right information is not obtained; and
- The reporting of additional information in order to present a complete image of transactions and events.

For accountants to give proper stewardship of agency theory, they also have to comply with the conditions of IFRS.

Empirical Framework

Osisoma and Enahoro (2006) carried out a study to determine whether financial accounting information users in Nigeria are aware of creative accounting in the private sector of the economy in Lagos, Nigeria. The study found out that creative accounting has definitely affected information users. Hence, in Nigeria, it is believed that the practice of creative accounting is constructive to the benefit of the manipulators of accounts. Osisoma and Enahoro (2006) also found out that the genuinely positive aspect of the corporation is presented to the fullest proportion to the public, while the area of weakness is played down by reporting in anticipation of correcting the weakness. The financial status is enhanced to enable the company to be attractive. However, creative accounting is manipulation for falsification and it gives erroneous impression of the reality and this is fraudulent.

Moldovan, Achim, and Avram, (2010) studied the role of creative accounting as a technique of accounts manipulation in contrast with the fair view presentation, and the ethics of accounting profession. In addition, they explained the inverse casual relationship between creative accounting and fair view principle and it was recommended that companies should comply with accounting rules and professional accounting ethics. These solutions are characterized by its practicability and can be put into practice by the company itself and by other interested users.

Desai and Dharmapala (2006) carried out a study to determine the relationship between earnings management and corporate tax avoidance. They advanced empirical evidence to indicate that conceptualizing corporate tax avoidance within an agency perspective provides a fuller and more accurate depiction of the motivations during this phenomenon. This meant that tax shelter products enable managers to manipulate reported earnings to mask true economic performance of their companies.

Dahdouh, (2006) carried out a related study to the subject of creative accounting and the role of auditors on this issue. The study centered on determining the problem of fraudulent activities in financial statements, and to identify the factors that culminate in failure of several large corporations all over the world. The study focused on the role of auditors in detecting fraudulent practices in Jordan. The study revealed that there are several factors associated with auditors, and other factors associated with the firm that can help in detecting fraud practices in financial statements. The most important conclusion of the study is that auditors' ability in detecting fraudulent in financial statements is influenced by different associated factors with the issuances of these companies. Merchant and Rockness (1994) investigated the motives for creative accounting and found that explicit self interest and motivated creative accounting got higher disapproval than where the motive is to promote the company.

Ibanichuka & Ihendinihu (2012) investigated the relationship between creative accounting and reported financial performance of banks and insurance companies in Nigeria, and the extent to which creative accounting impact on their dividend payout ratio. The results showed that creative accounting techniques were positively associated with firm financial performance and have significant effect on Dividend Payout (DPO). The work concluded that the desire to showcase impressive picture of corporate profitability through payment of enhanced dividend often breaches professional ethics in financial reporting. The study recommended a more stringent regulatory regime with effective enforcement mechanisms to ensure compliance with accounting and auditing standards.

Cormier and Lapointe (2006) carried out a study on auditors assessment and detection of corporate fraud by examining and assessing the ability of auditors to detect fraud in accounting data under a free environment of audit standards that do not enforce auditors to take the details and test of fraud detection in Canada. The study found that auditors put more emphasis on the factors of fraud risk which is associated with fraud over audit steps. Estimating the factors of fraud risks auditors focus on the primary analysis, where they have more ability to detect fraud.

These prior researches and existing literature however failed to determine and investigate how this negative practice of creative accounting can be curbed either through the adoption of International Financial Reporting Standards or through the enhanced scrutiny of the act of auditing. It is this gap that therefore necessitated a research in this area.

METHODOLOGY

Research Design

The research design used for this study is the survey research design method where a fractional part of the population is studied. The reason for using this method stems from the fact that it has been successfully used in researches of this nature. Odia and Ogiedu (2013) used this method successfully in their research on creative accounting and corporate governance in Nigeria. It was also used in New-Zealand by Amat, Blake and Dowds (1999).

Sample

The sample was randomly selected from a population made up of Firms of Chartered Accountants, companies' accountants and accounting lecturers in Kwara State. Since the research design employed was a survey, the random sampling technique was employed in the study.

Data Collection

The main instrument used for the collection of data is the questionnaire, which was designed in five response options of Likert-Scale. Each degree of agreement is given a numerical value from one (1) to five (5), where one is the lowest and five is the highest level with expression of optimism. Thus, a total numerical value can be calculated from all responses. A total of 110 questionnaire forms were administered to respondents of which 70 questionnaire forms were returned as usable representing a 64% response rate. The first section of the questionnaire concerns demographic questions. These questions include the responders' age, gender, and educational level, year of experience and managerial position. In the second section, in order to fulfill the purpose of the research, 16 questions were used to address the main objectives of the study.

Model specification

This model was used to test the conjectural statements of Hypotheses I and II which are: that the adoption of International Financial Reporting Standard (IFRS) does not have any significant influence in preventing creative accounting practices in Nigeria; and that there is no significant relationship between the acts of auditing and the detection of creative practices.

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RESEARCH FINDINGS

The data used for this study were gathered through administration of structured questionnaire. The statistical tool used in the data analysis and in the hypothesis testing is the Generalized Least Squares technique which was used in testing the hypotheses. The experimental variables examined were Creative accounting practices, International financial reporting standards, and Auditing practices.

Hypothesis testing

The first and second hypotheses stated earlier in this study are hereby tested using the Generalized Least Square Technique.

Ho₁ The adoption of International financial reporting standards does not have significant influence in preventing creative accounting practices in Nigeria.

Ho₂ There is no significant relationship between auditing practices of companies and the detection of creative accounting practices.

In testing these hypotheses, the data generated were used and the result obtained is presented in the Table 1 and Table II below:

Table 1: GLS Computation for test of Hypothesis I

Variable	Coefficient	Std. Error	z-Statistic	Prob.
IFRS	-0.131548	0.070144	-1.875394	0.0607
C	2.613227	0.340778	7.668425	0.0000

Source: Authors Computation, 2016

Table 1 shows the result of data analysis computed using SPSS. The table shows the Beta coefficient which gives the necessary information to predict creative accounting practices from IFRS adoption as well as determine whether IFRS adoption contributes statistically significantly to the model or not. The finding shows that adoption of IFRS reduces the level of creative accounting practices.

Table 2: GLS Computation for test of Hypothesis II

Variable	Coefficient	Std. Error	z-Statistic	Prob.
AP	-0.330793	0.070974	-4.660733	-0.0000
C	2.613227	0.340778	7.668425	0.0000

Source: Authors Computation, 2016

Table 2 shows the result of data analysis computed using SPSS. The table shows the Beta coefficient which gives the necessary information to predict creative accounting practices from audit practices as well as determine whether audit practices contribute statistically significantly to the model or not. The finding shows that auditing practices helps in the detection of creative accounting practices.

Discussion of Findings

The Generalized least square technique was used in the analysis above because of the presence of serial correlation in the collected data. The probability value of LR statistics which is significant at less than 1% shows that the problem has been corrected. The coefficients of Auditing Practices (AP) and International Financial Reporting Standard (IFRS) have their expected negative signs. This implies a negative relationship between the explanatory variables and the dependent variable. This further implies that an increase in the acts of auditing by 1% will lead to a decline in creative accounting practices by about 33%. The coefficients of International Financial Reporting Standards (IFRS) imply that an improvement in the standard by 1 percent will lead to a decline in creative accounting practices (CAP) by 13%. The probability value of this coefficient also shows how significant these variables are in curbing creative accounting practices to barest minimum. Both coefficients are significant at 1% and 10% respectively. This implies that International Financial Reporting Standards (IFRS) is significant in preventing creative accounting practices in Nigeria and that Auditing Practices of companies (AP) is also significant in the detection of creative accounting practices.

CONCLUSION AND RECOMMENDATIONS

Creative accounting offers a formidable challenge to the accounting profession and the credibility of accounting principles and standards. The results of this analysis clearly reveal that creative accounting practices have adverse effects on the quality of financial information. Financial statements are the most important part of accounting, which assist investor to make investment decision as they could provide valuable information about the wealth, performance and financial health of a company. Though, companies are able to control the financial statements through various types of creative accounting techniques, the study also revealed that the new International Financial Reporting Standard will go a long way to reduce the practice, since it covers more areas than the former practice. The role of International Financial Reporting Standards (IFRS) requires financial reporting to provide a true and fair view. Lastly, this study also concludes that enhanced scrutiny of auditing practice can be useful in detecting the practice if any does occur. This result does not differ from the work of Dahdouh (2006) who claimed that auditors' ability to detect creative accounting is influenced by the different associated factors related to both the auditors and the firm, meaning there is a significant relationship between auditing practices of companies and the detection of creative accounting practices.

Based on the findings generated from this study, the following recommendations were made:

- i. The one set of global financial reporting standards known as International Financial Reporting Standard (IFRS) must be embraced by all preparers of financial statements or those performing accounting function.
- ii. The accounting profession should strengthen its ethical code so that the individual accountant or auditor will be less willing to engage in creative accounting. Specifically, when auditors follow the ethical rules of their profession, they will be able to play more important role in detecting the different methods of creative accounting practices, and they will be able to add enough solutions to this negative practice.
- iii. Punitive measures should be meted to those that engage in the practice by law courts, accounting bodies and other regulatory agencies to stop the practice in order to ensure a good quality of financial information.
- iv. The introduction of forensic accounting practice that will serve as investigative check-point should be embraced in the Nigerian companies (both manufacturing and non-manufacturing sectors).

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