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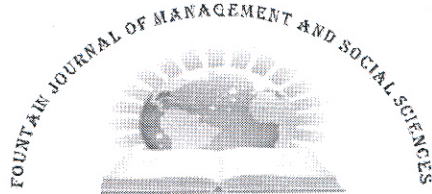


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CREATIVE ACCOUNTING AND BANK PERFORMANCE - EVIDENCE FROM NIGERIAN BANKING SECTOR

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Abstract

The study empirically examines the impact of creative accounting on firm performance in Nigeria using econometric analysis method on annual data of seven financial institutions over the period of 2006-2011. The results from Levin, Chin Chun unit root test shows that the all the variables were non-stationary at level. The results from the panel least square shows that non-performing loan is positively related to return on equity and dividend pay-out while gearing ratio and net income before tax is negatively related to both return on equity and dividend pay-out. The study recommends that the need for a stronger regulatory regime with effective enforcement mechanisms for ensuring compliance with accounting and auditing standards cannot be over emphasized. This should improve quality of financial statements as misstatements of financial statements would attract prosecution of offenders. Thus, the enthronement of a more stringent regulatory regime with effective enforcement mechanism will ensure compliance with accounting and auditing standards.

Keywords: Creative Accounting; Bank Performance; Financial institutions; PLS; Nigeria

Introduction

Creative accounting, also called earnings management, aggressive accounting, according to Ignacio (2009) is the manipulation of financial numbers, usually within the letter of the rules of law and standard accounting practices, but deviating from the spirit of those rules and certainly not providing the true and fair view that accounts are supposed to. Mulford and Comiskey (2002) identified creative accounting practices to include: recognizing premature or fictitious revenue, aggressive capitalization and extended amortization policies, misreported assets and liabilities, getting creative with income statement and problems with cash flow reporting. They added that managers play this game for rewards as favourable effect on share prices, lower corporate borrowing costs due to an improved credit rating, incentive compensation plans for officers and key employees and or political gains. The basic questions put forward to address this are: Can a firm increase its market value by creative accounting? Do shareholders and investors take the accounting figures at face value? Or are the firm's shares traded in efficient, well functional markets in which investors can see through such financial illusion?

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Empirical studies on these issues differ and this study hopes to contribute to this intellectual discourse by gathering data from Nigeria to test the null hypothesis that Creative accounting does not have significant positive impact on banks' performance.

According to Osisioma and Enahoro (2006), accounting processes and choice of policies resulting from many judgments at the same time are capable of manipulation, which have resulted in creative accounting. The differences which are observed in financial reporting are legitimately prepared from choice of varied accounting policies of the same organization for the same period, has brought about challenges of credibility to accounting (financially statements and reporting). It is upon this backdrop that the study intends to find out whether the practices of creative accounting affected financial reporting in Nigeria. However, communications between entities and shareholders may be deliberately distorted by the activities of financial statement preparers who wish to alter the content of the message being transmitted.

What has become worrisome; however, is the fact that many users of accounting information have had disappointing experiences by their reliance on accounting data. Companies have gone into liquidation soon after providing 'beautiful' results of their operations to users. In Nigeria for instance, most banks that collapsed in the late 1990's and early 2000's had fantastic audited results. This of course, became a challenge to the professional bodies whose members were auditors and accountants of such failed banks as society questioned the integrity of such experts. Society believe that accountants and auditors are obligated to the organizations they serve, their profession, the public and themselves to maintain the highest standards of ethical behaviour. The basic question therefore is: Is it that the management of such failed organization lied in the reports provided to users? Why didn't auditors discover such misrepresentations? The answer lies largely on the fact that such organizations engaged in creative accounting. However, since it has been established that there are many reports of price manipulations, profit overstatements, and accounts falsification by some dubious stewards which rendered the financial reporting ineffective. Hence, the business failures of the past decade however, have been closely associated with corporate governance failure which involves a number of parties, management board of directors, auditors and some investors. Limited studies [Aremu & Bello (2004); Ezeani, et. al. (2012); Idris, et. al. (2012); Osisioma & Enahoro (2006)] have been conducted in this area using primary data. The former examines the impact of creative accounting on managerial decision while the latter investigates implication of creative accounting on dividend payout of companies in the financial sub-sector of Nigerian economy. Therefore, this research intends to fill the gap in the literature by critically evaluating the impact of creative accounting on Nigerian bank performance.

Review of Relevant Literatures

Conceptual Framework

The term creative accounting was first used in 1968 in a film produced by Mel Brooks. Creative accounting according to Ignacio (2009) is accounting practices that deviate from standard accounting practices. These practices are characterized by excessive compilation and the use of novel ways of charactering income, assets or liabilities. Creative accounting has led to a number of recent accounting scandals, and many proposals for accounting reform that centered on an updated analysis of capital and factors of production that would correctly reflect how value is added (Osisioma and Enahoro, 2006). Creative accounting, as a matter of approach, is not objectionable per se. However, when unethical elements make intrusion, the resultant accounting details becomes anything but true and fair. Creativity in such context is like referring to a half glass of water as half-full instead of describing it as half-empty. While both statements are factually correct, they paint different pictures and thus convey different images. Creativity in company accounting may arise under at least three different financial market conditions. The first is when a company floats its shares to attract investors to subscribe to such shares either at par or at a premium, depending on the financial market evaluation of the company's future prospects. The second is when the company whose shares are already listed in a stock exchange, wants to paint an attractive picture of its financial conditions so that the shares may be quoted at a premium.

Finally, a company having its shares listed in the stock exchange may declare and pay high dividends based on inflated profits through overvaluation of assets, undervaluation of liabilities and change in systems of stock valuation that may boost the image of the company at least in the short run. Unethical considerations in creative accounts have developed to such depths that terms like fraud audit and forensic accounting have gained currency and are becoming new professions. Accounting practitioners and auditors are increasingly required to appear in courts for deposition.

Feleaga and Malciu (2002) stated that creative accounting was defined as a process through which the accounting professionals use their knowledge in order to manipulate the figures contained in the annual accounts. Although there are misunderstandings regarding the definition of creative accounting, the majority of researchers accept the idea that this stands out through two aspects. The first aspect has in view the use of the accounting professionals' imagination in order to translate those juridical, economic and financial innovations for which there are no normalized accounting solutions at the time of their occurrence. The second aspect shows the fact that the adjustments resulting from this financial engineering are initiated according to their incidence on the enterprise's balance sheet and result.

Theoretical Framework

The theoretical framework for the understanding of the accounting manipulation practices among others are underpinned by Resource Dependency, Agency Theory, Information Theory and Ethical Theory.

Resource Dependency

Performance on the part of the managers might be affected if shareholders were concerned with whether managers had sufficient control over their firms. Resource dependence concerns more than the external organizations that provide, distribute, finance, and compete with a firm. Although executive decisions have more individual weight than non-executive decisions, in aggregate the latter have greater organizational impact. Managers throughout the organization understand their success is tied to customer demand. Managers' careers thrive when customer demand expands. Thus customers are the ultimate resource on which companies depend. Although this seems obvious in terms of revenue, it is actually organizational incentives that make management see customers as a resource. Recently, resource dependence theory has been under scrutiny in several review and meta-analytic studies: Hillman et al. (2009); Davis and Cobb (2010); Drees & Heugens (2013); Sharif & Yeoh (2014). Which all indicate and discuss the importance of this theory in explaining the actions of organizations, by forming interlocks, alliances, joint ventures, and mergers and acquisitions, in striving to overcome dependencies and improve an organizational autonomy and legitimacy.

Agency Theory

Contrary to the resource dependency perspective, an agency theory perspective according to Li, (2011) suggests that if owners are concerned that managers' interests are not in congruence with their own and that managers will act in ways that will prevent profit maximization and potentially threaten the company's existence, then owners must believe that such managers have a great deal of control over the firm. In order to show the appropriateness of their conduct, managers will emphasize their role in positive outcomes, and maximize their role in negative outcomes. To the extent that one would expect the Enron scandal to be on the minds of most top management teams. One might expect to find this effect regardless of firm characteristics.

Information Theory

The information perspective or theory according to Ball, (2013) is a key element underpinning the study of the creative accounting phenomenon. A conflict is created by the information asymmetry that exists in corporate structures between a privileged management and a more remote body of stakeholders. Managers may choose to exploit their privileged position for private gains by managing financial reporting disclosure in their own favour. The information perspective assumes that accounting disclosures have information content that possesses value to stakeholders in providing useful signals. It may be difficult or impossible for individual stakeholders to discern the fact and the effect of accounting manipulation, because of an insufficient personal skill, indifference or an unwillingness to engage in detailed analysis.

Ethical Theory

Velayutham, (2003) opined that companies generally prefer to report a steady trend of growth in profit rather than to show volatile profits with a series of dramatic rises and falls. This is achieved by making unnecessary high provisions for liabilities and against assets values in good years so that these provisions can be reduced, thereby improving reported profits, in bad years. Advocates of this approach argue that it is a measure against the 'short-termism' of judging an investment on the basis of the yield achieved in the immediate following years. It also avoids raising expectations so high in good years that the company is unable to deliver what is required subsequently. Against this is argued that if the trading conditions of a business are in fact volatile then investors have a right to know this and that income smoothing may conceal long-term changes in the profit trend. Revinse (1991) considers the problem in relation to both managers and shareholders and argues that each can draw benefits from 'loose' accounting standards that provide manager with latitude in timing the reporting of income. He thinks that the prime role of accounting is a mechanism for monitoring contracts between managers and other groups that provided finance also market mechanisms will operate efficiently, identifying the prospect of accounting manipulation and reflecting the appropriateness in pricing and contracting decisions.

Empirical Evidence of the Study

Amat, et. al. (2003), in their study showed that accountants accept the ethical challenge in that creative accounting raises need to be aware of the scope for both abuse of accounting policy choice and manipulation of transactions. Still in a study carried out by Sen and Inanga (2005), in Bangladesha found that creative accounting include: conceal financial risk, circumvent borrowing restrictions, escape shareholder control, boost, reported profits/ minimize reported losses, manipulate key ratios used in market analysis, enhance management performance and gain access to finance, would otherwise be impossible to raise. They also found out that if creative accounting is practiced by any organization there is plenty of scope of maneuvering and manipulation of accounting information such manipulation might leave the shareholder, public, the government and any interested party absolutely confused as to what is and what is not real and true in connection with a published set of accounting statements.

Velayutham, (2003) in a survey of 1,500 accountants in Australia, found that creative accounting as an ethical issue ranks above tax evasion. Merchant and Rockness (1994) investigated the motives for creative accounting and found that explicit self-interest motivated creative accounting got higher disapproval than where the motive is to promote the company. Also, they found that accountants are more critical of abuse of accounting rules than of manipulation of transaction.

Sen and Inanga (2005) found evidence of creative accounting by firms in Bangladesh which they traced to conflict of interest amongst different groups that the accountant wants to serve. Accounts are therefore prepared to serve the particular group the accountant so wishes.

Gowthorpe and Amat (2005) characterized ethical issues in accounting by positing that accounting regulation shares many features with systems of law. These systems are societal constructs which mirrors issues of individual morality and fundamental moral values as truthfulness.

Data Collection and Analysis

The data for this research were generated through secondary source. The variables considered in this study are non-performing loan, net income after tax, net income before tax, gearing ratio and cash flow ratio as independent variables; while return on equity and dividend pay-out are the dependent variable. Data on these variables were collected from annual financial report of financial institution from 2006 -2011. The model adopted for this study is a modified Jones model (1995). This model becomes imperative against the background that the study sets to establish the impact of creative accounting bank performance in Nigeria. This involves using return on equity (ROE) and dividend pay-out (DIVPO) as dependent variable; while non-performing loan (NPLs), net income before tax (NIBT), net income after tax (NIAT), gearing ratio (GERAT) and cash flow ratio (CASFR) as independent variables. Hence the aggregated model is:

Model 1

$$ROE = F(NPLS, NIBT, NIAT, GERAT, CASFR) \quad (1)$$

The model in its econometric form is as follows:

$$ROE = a_0 + b_1NPLS + b_2NIBT + b_3NIAT + b_4GERAT + b_5CASFR + \mu \quad (2)$$

Model 2

$$DIVPO = F(NPLS, NIBT, NIAT, GERAT, CASFR) \quad (3)$$

The model in its econometric form is as follows:

$$DIVPO = a_0 + b_1NPLS + b_2NIBT + b_3NIAT + b_4GERAT + b_5CASFR + \mu \quad (4)$$

Where ROE is return on equity

DIVPO is dividend payout

NPLs is non-performing loan

NIBT is net income before tax

NIAT is net income after tax

GERAT is gearing ratio

CASFR is cash flow ratio

B_0 = slope of the model

B_1, B_2, B_3, B_4 = coefficient of parameters

Presentation and Interpretation of Data

Table 4.1 Showing Levin Lin and Chu

VARAIBLES	Levin lin and chut	ORDER OF INTERGRATION	PROBABILITY
ROE	-2.75104	I(0)	0.0030
DIVPO	-2.08636	I(0)	0.0185
NIBT	-4.42359	I(0)	0.0000
NIAT	-7.98061	I(0)	0.0000
NPLS	-6.17445	I(0)	0.0000
GREAT	-3.52760	I(0)	0.0002
CASFR	-5.27598	I(0)	0.0000

Source: Author's Computation (2014)

NOTE: The null Hypothesis is the presence of Unit root in ROE, DIVPO, NIBT, NIAT, NPLS, GREAT, and CASFR. Levin, Lin and Chu Test includes a constant, Akaike Information Criterion was used to select lags automatically. * denotes significance at all levels (1%, 5% and 10%).

Result of Unit Root Test

The unit root test is conducted on the variables used in this study in order to avoid a spurious regression. From the above results, it shows that the datas are all stationary at level. Moreover, considering the low probability value and critical values that are significant at 1%, 5% and 10% when compare to the Im, Pesaran and Shine Test statistics.

The above result show that ROE, DIVPO, NBT, NAT, NPLS, GREAT, and CASFR are stationary series at level form but became an I(0) series. This implies that the Levin, Lin and Chu Test suggest that , ROE, DIVPO, NIBT, NIAT, NPLS, GREAT, and CASFR are of the same order of integration.

Descriptive Statistics

The summary of the statistics used in this empirical study is presented in Table below. As may be observed from the Table, GERAT as it has the lowest mean value of 0.688995 and the mean value of NIAT has the highest mean value of 4682227. Whereas the mean values of NIBT, DIVPO, CASFR, NPLS, and ROE are 4416139, 109598.4, 1.372348, 1.936150 and 2.096538 respectively. The analysis was also fortified by the values of the skewness and kurtosis of all the variables involved in the models. Hence, all the variables were positively skewed meaning that the mass of the distribution is concentrated on the right (that is, it is said to be left-skewed. The implication of this is that the skewness tends to say more on the mean value of the distribution being higher or lower than the median. Hence, positively skewed value indicates a higher mean value over the median value. On the part of Kurtosis, all the variables used present positive kurtosis value which means that the distribution is leptokurtic (too tall).

Table 4.2 Showing Summary of Statistics of the Variables

	ROE	NPLS	NIBT	NIAT	GREAT	CASFR	DIVPO
Mean	2.096538	1.936150	4416139.	4682227.	0.688995	1.372348	109598.4
Std. Dev.	1.476455	7.680661	13347010	11870784	0.865504	3.246979	3130989.
Skewness	0.342486	4.901518	2.440535	1.951934	2.359971	4.351302	0.597203
Kurtosis	3.177867	27.07632	11.83263	8.333596	7.203763	22.54086	8.847404
Observations	42	42	42	42	42	42	42

Source: Author's Computation (2014)

Table 4.3: Panel Least Square

Dependent Independent	ROE	DIVPO
NPLS	0.02945 (0.0029)	0.024294 (0.0089)
NIBT	-1.80E-05 (0.9334)	-17127.5 (0.0021)
NIAT	1.30E-0.8 (0.5969)	-0.019721 (0.6695)
CASF	-0.143241 (0.1700)	490531.8 (0.0268)
GREAT	-0.295548 (0.0044)	-651940.5 (0.0005)
R ²	0.565444	0.644940
ADJ R ²	0.504812	0.648404
F-STAT	2.737126 (0.033949)	3.158814 (0.018243)
DURBIN WATSON	1.775451	1.896269

Source: Author's Computation (2014)

Interpretation and Discussion of Return on Equity

The panel least square (PLS) result shows that NPLS and NIAT have a positive relationship with ROE whereas NIBT, CASFR and GERAT have negative relationship on ROE. NPLS and GERAT is significant at 1% but NIBT, NIAT, CASFR AND GERAT are not significant at any percent. The result obtained from the static model indicate that the overall co-efficient of determination R² show that 56.54% of ROE is explained by the variables in the equation which is a good fit because its significant is above the bench mark of 50%. As adjusted (R²) tends to purge the influence of the number of the included explanatory variables, the R² of 0.5048 shows having removed the influence of the explanatory variables, the dependent variable is explained in the equation by 50.48%. The calculated f-statistics is greater than the tabulated f-statistics which is significant at 5%. The Durbin Watson statistics of 1.77 as it's significant below the bench mark of 2 which can conclude that there is no auto correlation in the model specification.

Interpretation and Discussion of Dividend Payout

The panel least square (PLS) result shows that NPLS and CASFR has a positive relationship with ROE whereas NIBT, NIAT and GERAT has negative relationship on ROE. NIBT, NPLS, GERAT is significant at 1% and CASFR is significant at 5% but, NIAT not significant at any percent. The result obtained from the static model indicate that the overall co-efficient of determination R² show that 64.49% of ROE is explained by the variables in the equation which has a good fit because its significant is above the bench mark of 50%. As adjusted (R²) tends to purge the influence of the number of the included the explanatory variables, the R² of 0.6484 shows having removed the influence of the explanatory variables, the dependent variable is explained in the equation by 64.84%. The calculated f-statistics is greater than the tabulated f-statistics which is significant at 5%. The Durbin Watson statistics of 1.8962 as its significant below the bench mark of 2 which can be concluded that there is no auto correlation in d model specification.

Conclusion

This study examined the relationship between creative accounting on managerial decision on some selected financial institutions. The data collected were from seven financial institutions between 2006-2011. The findings of the study revealed that two dependent variables tested (ROE, DIVPO) are significantly associated with creative accounting. In this particular study, ROE is negatively associated with NIBT, CASFR and GERAT indicating the possible existence of income decreasing earnings management. Whereas the NPLs and NIAT is positively associated with ROE indicating that creative accounting exists when operational risk is high. The conclusion of this study is important to note because if the value of the shareholders' equity goes down, ROE goes up. Thus, write-downs and share buybacks can artificially boost ROE. Likewise, a high level of debt can artificially boost ROE; after all, the more debt a company has, the less shareholders' equity it has (as a percentage of total assets) and the higher its ROE is. Investors may also calculate the change in ROE for a period by first using the shareholders' equity figure from the beginning of a period as a denominator to determine the beginning ROE. Non-performing loan and net income have a positive relationship on return on equity while cash flow ratio, gearing ratio and net income before tax have a negative relationship on return on equity. However a company with high gearing ratio (high leverage) is more vulnerable to downturns in the business cycle because the company must continue to service its debt regardless of how bad sales are. The higher a company's degree of leverage, the more the company is considered risky. As for most ratios, an acceptable level is determined by its comparison to ratios of companies in the same industry. The gearing ratio is negatively related to return on equity, and it is significant at 1%. High gearing ratio leads to high debt in an organization.

Recommendations

The study recommends that the need for a stronger regulatory regime with effective enforcement mechanisms for ensuring compliance with accounting and auditing standards cannot be over emphasized. This should improve quality of financial statements as misstatements of financial statements would attract prosecution of offenders. Thus, the entrenchment of a more stringent regulatory regime with effective enforcement mechanism will ensure compliance with accounting and auditing standards.

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