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Creative Accounting and Entity Operational Environment: The Nigerian Moral Experiments

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Abstract
This study is an empirical investigation into creative accounting and its moral justification in Nigeria. The population comprised firms of chartered accountants and accountants in academic. The sample consisted of 110 respondents (accountants). The major instrument used for generating the primary data was a questionnaire, which was designed by the researchers based on a five-response option of Likert type Scale. The data generated were analyzed through Generalized Least Square Technique *(GLST). A total of 110 questionnaires were administered on the respondents, out of which 70 were retrieved for analysis. The study* revealed that creative accounting practices have adverse effects on the quality of financial information. *From the findings, it was recommended that entities should comply with the new International Financial Reporting Standard (IFRS) 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: *Creative Accounting, International Financial Reporting Standards, Auditing, Forensic Accounting.*

Introduction

The focus of financial reporting is to provide information about the wealth performance and financial health of an entity. 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 when reading the reports; the figures may not necessarily show a true and fair view and might also be misleading (Ibanichuka, & Ihendinihu, 2012). According to the framework for the presentation and preparation of financial statements of the IASB, the analysis of the qualitative characteristics of accounting information is carried out around four vectors namely, understandability, relevance, reliability and comparability. These characteristics considered principal are supported by several related attributes: the relative importance, the accurate image, the priority of economic content over the judicial nature, neutrality, prudence and sufficiency. Relevant information, which when is used can make the difference between the decisions of the users must have predictive value and/or confirmatory value. Additionally, information is material if its omission might influence the decisions that users take based on the financial information about a specific entity (Popescu, & Nişulescu, 2013).

However, the critical inquiry of the present state of global regulations and the scientific works for preventing and detecting creative accounting (Popescu, & Nişulescu, 2013), the accounting process and regulatory framework prescribed by the different regulatory agencies in the accounting profession gives 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 (Idris, Kehinde, Ajemunigbohun & Gabriel, 2012). These negatively practiced activities by the less scrupulous elements of the accounting profession are popularly known as Creative Accounting. Creative accounting at an individual entity level involves preparers in altering accounting disclosures so as to create the view of reality that they wish to have communicated to users of financial statements. This type of behavior is described as micro –manipulation (Amat & Gowthorpe, 2004) and it is also called creative accounting in the UK, as well as earnings management in the US. (Ezeani, Ogbonna, Ezemoyih & Okonye, 2012).
Creative Accounting has become a topical issue and current issue of late, particularly since the collapse of Enron and other corporate entities in U.S.A. like WorldCom, Tyco, Xerox, and HealthSouth 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 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 was sacked by the Central Bank of Nigeria (CBB) have been linked to creative accounting practices (Odia & Ogiedu, 2013). 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 becomes threatened day by day. Also, the challenge of creative accounting goes to the heart of business regulation, business ethics and other fields. These challenges certainly constitute a threat not only to corporate investment but also business growth. Previous studies show that creative accounting practices occur because management has the discretion to choose accounting principles while preparing financial statements. This study therefore examines creative accounting practices as a whole, 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:

❖ Can the adoption of International financial reporting standard prevent the incidence of creative accounting practices in Nigeria?
❖ Can there be any relationship between auditing practices of entities and the discovery 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:

❖ evaluate the effect of international financial reporting standards in preventing creative accounting practices in Nigeria.
❖ investigate the usefulness of auditing practices of companies in detecting the practices of creative accounting.

Research Hypotheses

The researchers formulate the following hypotheses stated in their null form to empirically test the data collected:

Ho_1: The adoption of International financial reporting standards does not have significant influence in preventing creative accounting in Nigeria.

Ho_2: There is no significant relationship between auditing practices of entities and the detection of creative accounting.

Conceptual Framework

Creative Accounting refers to the use of accounting knowledge to influence the reported figures, while remaining within the jurisdiction of accounting rules and laws, so that instead of showing the actual performance or position of the company, they reflect what the management wants to tell the stakeholders **(**Yadav, 2014).

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 USA (Amat and Gowthorpe, 2004). However, the term Creative Accounting" was first originated with the movie "The Producers" by Mel Brooks in 1968. In this movie the producers of a play deceive the backers of their play by selling many times over the total value of the enterprise based on the assumption that the play will be unsuccessful, the backers will expect no financial gain, and the producers will have a ill-gotten profit. However, the play becomes very successful surprisingly, creating a sensation making the plans of the producer's flop. Creative accounting has been described in a number of ways by both experts and non-experts in accounting and finance. Ghosh (2010) defined creative accounting as the transformation of accounting figures from what they actually are to what perpetrators desire by taking advantage of the existing rules and/or ignoring some or all of such rules/guidelines.

Griffiths (1986) writing from the perspective of a business journalist, described 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)* (see also Terry Smith, 1992). Naser (1993) presenting an academic's view, offers a definition: *"Creative accounting is 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" (p. 2)*

The opinions expressed by the authors actually have two features in common, which is observed by Naser (1993): They perceive the incidence of creative accounting to be common; and They see creative accounting as a deceitful and undesirable practice. Also, several methods can be followed to practice creative accounting, (Amat, Blake, and Dowds (1999).

For this research work, the study defines creative as the use of judgment by administrators in financial reporting and in structuring transactions to alter financial reports with the intent to either misrepresent some investors about the true economic performance of an entity, or influence contractual outcomes that depend on reported accounting number using the loopholes in the regulatory framework of accounting.

Various research studies have examined the issue of management motivation towards creative accounting behavior. According to Hepworth (1953), several motivations including the existence of tax levies 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: Income Smoothing; Comply with the limits included in predictions; and 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 as to the reasons for resorting to creative accounting: Personal incentives like granting certain bonuses, salary increases, job security, personal satisfaction; External expectations such as analysts' expectations achievement, turning profits, employment in existing rules; Special circumstances inform of new issues of shares, loans management, mergers and acquisitions, new management team, waiting for better times; and Covering fraud like 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 mentioned as a significant motivator by Niskanen & Keloharju (2000) in a Finnish context and in Japan by Herrmann & Inoue (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

Some of the theoretical perspectives used to provide a framework for research in the history of public sector accounting do not provide differential theorisations for entities in the public and the private sectors. This may lead researchers to look for similarities rather than differences, but well-grounded research into public sector accounting should continue to provide insights for historical understandings of accounting more generally. Balaciu, Bogdan and Vladu (2009) noted that there is no universally or unanimously accepted theory for studying creative accounting. This is because of the varying positive values and negative values of creative accounting. Hence, this study reviews relevant theories often used in the discussion of creative accounting and takes position.

Information Theory

Accountants should be particularly interested in a body of knowledge that has been developing in recent years, and which has become variously known as information theory, information science, and information technology. This body of knowledge has been concerned with information in

general. More specifically, it has been concerned with the meaning of the term "information", and with the measurement and valuation of the informational content of messages. Whilst information theory is concerned with information in general, and accounting is merely concerned with a particular type of information, the relevance of the theory to accounting should be obvious.
However, the dominant nature of accounting lies in an information communication system. More precisely, accounting is an application of the general theory of information to the efficient economic operations. The significance of information theory to accounting lies in the fact that it is a part of the decision making process that reduces uncertainty and thereby provides a means to improve the quality of decision. According to Bedford, however, a data becomes accounting information only when it is measured and is bounded by the criteria of relevance, verifiability, freedom from bias and quantifiability. Vatter elaborates this point when he says that "data become information only when they convey a message which has some specific relevance to a problem or situation-a relevance which may be expected to capture attention and to precipitate action". Under this theory, information is regarded as a resource, the collection, processing and transmission of which involve a cost. For Bailey (1970) information theory is directly related to cybernetics. Cybernetic systems require communication or flow of information to achieve self-regulation.
So far, the accounting theorists who make use of the information systems or cybernetics model have not attempted to describe the firm to which their programmes will apply. From the study of Schipper (1989), information theory was identified as an important aspect underpinning the study of the creative accounting practices. Vladu and Matis (2010) argued that information asymmetry has the potential to explain the multiple incentives found on the financial market to manipulate accounting data and further to assess the consequence of such behaviour. Studies which have used this theory (Spence, 1973; Rothschild and Stiglitz, 1976) argued that information asymmetry is regarded as a genesis point for manipulative behaviour. The argument is based on the belief that one side of the market has better information than the other. Breton and Taffler (1995) argued that managers may choose to exploit their privileged position for private gains by managing financial reporting disclosure in their own favour. The information theory 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

Ruland (1984) 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 immediately following years. Revinse (1991) investigated the problem in relation to both managers and shareholders and argued that each can draw benefits from 'loose' accounting standards that provide manager with latitude in timing the reporting of income. The study opined that accounting acts as 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 (creative accounting) and reflecting the appropriateness in pricing and contracting decisions. In Nigerian corporate environment, creative accounting practices are posing a serious threat to the credibility of public financials. There have been several cases of earnings management especially in the banking sector and this has raised many questions about the ethical standards of management and about the integrity of financial reports issued by professional accountants (Bakre, 2007; Ajibolade, 2008; Okike, 2009).

Empirical Review

Ezuwore-obodoekwe, and Agbo (2020), examined the effect of creative accounting practices on the performance of Nigerian banks. Primary data were obtained using questionnaire designed in five-response options of Likert-Scale. The population of this study comprised all the bank managers and accountants in Nigerian banks while the sample of the study was made up of 50 managers and 303 accountants drawn from all the banks currently operating in the Enugu metropolis. The findings reveal that the intentional manipulations or omissions of amounts or disclosures in financial statements has a significant negative effect on beating analysts' forecasts about future banking performance in Nigeria and (ii) the misreporting of assets and liabilities has a significant negative effect on attracting investors to Nigerian banks.

Olojede, Iyoha, and Egbide (2020), empirically studied the impact of corporate governance mechanisms on creative accounting practices in the listed companies in Nigeria. Longitudinal design for the study was used because repeated observation of the same variables are involved (corporate governance mechanisms and creative accounting practices) over a 13-year period (2005 -2017). The study population was 166 listed companies on the Nigerian Stock Exchange as at 31st December, 2017 and 70 companies were selected as a sample, using multi sampling technique. Data were collected for the variables from the companies' annual reports and accounts sourced from African Financials, Nigerian Stock Exchange and individual company websites. The study used descriptive statistics, correlation, OLS regression, panel fixed effects model (FEM) and panel random effects model (REM) for the analysis and hypothesis testing. The outcome of the study revealed that corporate governance mechanisms jointly have a great significant impact on creative accounting practices (CAP) in Nigeria, but the level of impact differs among individual corporate governance mechanisms. Audit committee and gender diversity have negative and significant relationship with creative accounting practices, showing that increase in either of them reduces unethical practices and manipulation of accounting numbers. The ownership concentration has a positive and significant impact on creative accounting practices. However, board size, board independence, managerial ownership and CEO duality are positive and do not have any significant impact on creative accounting practices.

Jesus, Pinheiro, Kaizeler, and Sarmento (2020), examined accounting environment and the risk of fraud, investigating the relationship between creative accounting and ethics. In order to analyze the level of discomfort, accountants perceive towards decisions that involve creative and fraudulent accounting practices, it was constructed a survey sent to 168 accountants, from 37 companies listed on Euronext Lisbon. Based on the data obtained from the responses to the survey and the statistical analysis performed, five dimensions creative accounting were identified. Accountants identify manipulation practices that are closer to fraud and that violate accounting and financial reporting standards and identify fewer creative practices which include less fraud and are more ethical creative accounting practices. It is concluded that creative accounting practices are not fraud. Ibanichuka & Ihendinihu (2012) investigated the relationship between creative accounting and reported financial performance of banks and insurance companies in Nigeria, and the extent creative accounting impact on their dividend payout ratio. The results show that creative accounting techniques are positively associated with firm financial performance and have significant effect on dividend payout (DPO). The work concludes that the desire to showcase impressive picture of corporate profitability through payment of enhanced dividend often breaches professional ethics in financial reporting. The study recommends a more stringent regulatory regime with effective enforcement mechanisms to ensure compliance with accounting and auditing standards.

Materials and Methods

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 research 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). The sample was randomly selected from a population made up of Firms of Chartered Accountants, companies' accountants and accounting lecturers in Abia State. 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 to optimistic answer. Thus, a total numerical value can be calculated from all responses. A total of 110 questionnaires were administered to respondents of which 70 questionnaires was retrieved as usable representing a 64% response rate.

Model Specification

This model was used to test the conjectural statement of Hypothesis I and Hypothesis II which is 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.

CAP = f (IFRS, AA)…………………………………………………….(1)

Where:

CAP=Creative Accounting Practices

IFRS= International Financial Reporting Standards

AA= Acts of Auditing.

Econometrically, it can be written thus:

$CAP= \alpha_0+ B_1IFRS+B_2AA+U$…………………………………………… (2)

Data Analysis and Interpretation

The data used for this study is ascertained from the administering of structured questionnaires. 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 to be examined are Creative accounting practices, International financial reporting standards, and Auditing Practices.

Hypothesis Testing

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

Ho_1 The adoption of International financial reporting standards does not have significant influence in preventing creative accounting practices in Nigeria.

Ho_2 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 below:

TABLE 1: GLS Computation for test of Hypothesis I and II

Variable	Coefficient	Std. Error	z-Statistic	Prob.
AP	-0.330793	0.070974	4.660733	0.0000
IFRS	-0.131548	0.070144	-1.875394	0.0607
C	2.613227	0.340778	7.668425	0.0000
Mean dependent var	3.271429	S.D. dependent variables		1.306854
Sum squared resid	84.88311	Log likelihood		-106.1061
Akaike info criterion	3.117317	Schwarz criterion		3.213681
Hannan-Quinn criter.	3.155594	Deviance		84.88311
Deviance statistic	1.266912	Restr. deviance		117.8429
LR statistic	26.01582	Prob(LR statistic)		0.000002
Pearson SSR	84.88311	Pearson statistic		1.266912
Dispersion	1.266912			

Source: *Authors Computation, 2025*

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) infer that an enhancement in the standard by 1% will lead to a decrease 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 operations in Nigeria and Auditing Practices of entities (AP) is also significant in the detection of creative accounting operations.

Conclusions

Creative accounting provides a daunting challenge to the accounting profession and the integrity of accounting principles and standards. The results of this analysis evidently show that creative accounting operations have adverse effects on the quality of financial information. Financial statements, as the most significant part of accounting, which support potential investor to make investment decision as they could offer valuable information about the wealth, performance and financial health of an entity. Though, entities are able to control the financial statements through various types of creative accounting techniques. However, 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. Therefore, the study concludes that improved analysis of auditing operation 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 operations of entities and the detection of creative accounting practices.

Recommendations

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

- 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 an accounting function.
- The accounting profession should reinforce its ethical code so that the individual accountant or auditor will be less willing to connive at creative accounting. Precisely, when auditors follow the ethical rules of their profession, they will be able to play more vital role in detecting the different procedures of creative accounting practices, and they will be able to add sufficient answers to this negative practice. Disciplinary actions on those that engage in the practice should be implemented by law courts, accounting bodies and other regulatory agencies to stop the practice to ensure a decent quality of financial information.

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