

## **The Effect of Creative Accounting on the Nigerian Banking Industry**

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**Abstract:** *This study examined the effect of creative accounting on the Nigerian banking industry with the purpose of determining the motive behind the practice of creative accounting in the Nigerian banking industry, to ascertain whether creative accounting has contributed to banks' distress in Nigeria, and to examine measures that could curb the practice in the Nigerian banking industry. Primary source of data collection was employed in this study and statistical tools used to analyze the data were the Kruskal-Wallis test and the multiple bar chart analysis. The result of this study revealed that the major reason for creative accounting practices in the Nigerian banking industry was to inflate the operating costs to reduce exposure to taxes. It was further found that other key reasons for creative accounting practice in the Nigerian banking industry include: to help maintain or boost the share price by reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend, to inflate the amount of operating costs in order to reduce exposure to taxes, to report a steady trend of growth in profit, rather than slow volatile profits with a series of dramatic rises and falls, and to effect changes in accounting policies in order to discourage findings faults in the company's accounting system. It was observed that that creative accounting has significant impact on banks distress in Nigeria and it was further observed that effective measures can curb the practice of creative accounting in the Nigerian banking industry.*

**Keywords:** *Banking industry, Accounting system, Share price, Profit, Accounting practice*

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### **1. INTRODUCTION**

Financial reporting is very crucial for the effective functioning of corporate governance systems. Current accounting practices allow a degree of choice of policies and professional judgment in determining the method of measurement, criteria for recognition and even the definition of the accounting entity. The exercise of this choice could involve a deliberate non-disclosure of information and manipulation of accounting figures, thereby making the business appear more profitable than it really is. While the financial number games may have different levels, participation in it has a singular objective which is creating an altered impression of a firm's business performance (Niskanem and Kebharju, 2000). With this practice, users of financial statements are many times misled and this constitutes a threat to corporate investment and growth. In line with this, (David, 1993) observed that with an all-too frequent occurrence, users of financial statements are shaken with the disclosures by the corporate management that certain accounting irregularities have been discovered and as a result, current and prior year financial results require some kind of review. This accounting practice is termed Creative Accounting.

#### **1.1 Creative Accounting, in focus**

In his expose` on the concept of creative accounting, (Smith, 1992) recounts how a private company, Brentford Nylon collapsed shortly after reporting profit of 130,000 pounds sterling. A study by (Leung and Cooper, 1995) highlighted that creative accounting is considered one of the major ethical problems of the accounting profession. The term Creative Accounting may have been used for the first time in the Mel Brook's film- "*the producers*" (Idris et al, 2012), but it is an age long practice. (Hussey and Ong, 1996) stated that creative accounting first became very prevalent in the 1980's. Due to loopholes of accounting regulations, companies could produce accounts which flattered their financial performance. Creative accounting is considered a

synonym for deceptive accounting (Yadav, 2013), which facilitates the financial reporting goals established by management. Creative accounting can also be referred to as Earnings management, “aggressive” or “innovative” or “Cosmetic” or “deceptive” accounting ( Idris et al, 2012).

The fundamentals of creative accounting were laid down in the seminal work on accounting, “De Arithmetica”, written by Italian mathematician, Luca Pacioli in 1494. Unreasonable and dishonestly excessive use of Creative Accounting led to the downfall down of numerous high profile companies in the United States during the great depression.

Creativity in accounting can be bad, that doesn't mean that it must be bad (Ali et al., 2011). Giving a rounded description of the concept, (Mathew and Perrera, 1996) noted that creative accounting has a positive effect if it enhances the development of accounting practices and a negative effect, when it is meant to mislead and defraud investors, creditors, bank customers and other users of financial statements. Creative accounting is defined as the practice of recognizing revenue in a way that makes a company look better than it is, while still conforming to the Generally Accepted Accounting Principles (GAAP). Agreeing, (Ali et al., 2011) sees Creative Accounting as 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. It refers to accounting techniques in which financial information is distorted and manipulated in order to present a better financial picture by either increasing or decreasing the profit as the case may be, by giving a misleading appearance of the capital size or structure and by concealing relevant information from existing and potential investors (Idris et al., 2012). On his part, (Alam, 1988) associates creative accounting with any or a combination of the following actions: creation of data, dressing up of documents, cooking up of accounts. Creative accounting is therefore the transformation of financial accounting figures from what they actually are to what the preparer desires by taking advantage of the existing rules and/or ignoring some or all of them (Naser, 1993). Creative accounting refers to the aggressive use of choices available under accounting rules, to present the most fattening view of a company possibly in its financial statement (Ijeoma and Aronu, 2013). According to them, it involves the pushing of accounting principles to the limits of their flexibility or even beyond so as to improve their annual statements.

(Ali et al., 2011) tried to give answer to why managers practice creative accounting and how they become successful in performing such practices in the presence of stringent rules and procedures. They also tried to explore whether creative accounting practice is good or whether it brings crisis in the companies and link of corporate governance with creative accounting. Most managers who practice creative accounting seek loopholes in financial reporting standard which they can exploit to adjust the numbers as much as is practicable to achieve their desired aim or satisfy their financial projections (Ijeoma and Aronu, 2013). The motivations for creative accounting include income smoothing, matching reported earning to profit forecasts, changes in accounting methods, boosting the market value of shares, delaying market information, inflation of operating costs, reducing exposure to taxes and paying less dividends. Since Creative accounting led to the collapse of high profile companies in the United states of America and England in the 1930's and 1940's, concern over the practice led to the formation of the Generally Accepted Accounting principles (GAAP), which are still in practice till date. Creative accounting as a matter of approach is not objectionable per se. However when unethical methods make intrusion, the resultant accounting details become 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 convey different images. Creativity in company accounting may arise when a company floats its shares to attract investors to subscribe to its shares either at par or at premium depending on the financial market evaluation of the company's future prospects; when a company whose shares are already listed in the stock exchange wants to paints an attractive picture of its financial conditions so that the shares may be quoted at a premium and when a company having its shares listed in the stock exchange declares and pays high dividends based on inflated profits through overvaluation of assets, undervaluation of liabilities and change in systems of stock valuation which may boost the image of the company at least, in the short run. On the methods of Creative Accounting, (Amat et al., 1999) identified choice of accounting policy, unavoidable degree of estimation of entries in the accounts, use of artificial transactions and timing of genuine transactions.

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According to (Mulford and Comiskey, 2002) creative accounting practices are classified into five categories:

- a. Recognizing Premature/ fictitious revenue: This entails recognizing revenue for a legitimate sale in a period prior to that called for by the Generally Accepted Accounting Principles (GAAP).
- b. Aggressive Capitalization and extended amortization: These are policies companies use to minimize expenses by aggressively capitalizing expenditures that should have been expensed or by amortizing capitalized amounts over extended periods.
- c. Misreported assets and liabilities: These include overstating assets that are not subject to annual amortization, such as accounts receivables, inventory and investments, and understating liabilities which may include accrues expenses payable, environmental claims and derivatives- related losses.
- d. Getting creative with the income statements: This refers to intentional manipulations or omissions of amounts or disclosures in financial statements, fiddling with profits or losses in the income statement for deceit and fraudulent intentions.
- e. Problems with cash flow reporting: This refers to ineffective and inaccurate recording of financial transactions (cash inflows and cash outflows in a business entity).

The real cause of creative accounting lies in the conflicts of interest among various interest groups. Managing shareholder interest is to pay less tax and dividends. Investor shareholders are interested in getting more dividends and capital gains. Country tax authorities would like to collect more and more taxes. Employees are interested in getting better salaries and higher profit shares. Creative accounting puts one or two to an advantage at the expense of others. (Schiff, 1993) warned investors in general that taking a company's financial statements at face value could be a recipe for disaster. He pointed out that Earnings per share (EPS), the only number which most investors often pay attention to, could be boosted by the stroke of an accountant's creative pen. Given the negative consequences of creative accounting practices in any financial system, (Domash, 2002) advised that financial statements which inflate the performance of companies by manipulating figures be stamped out as it puts investors and other users of financial information to great difficulties to distinguish between the paper entrepreneurs and the truly successful entrepreneurs.

### **1.2 Creative Accounting in the Nigerian Banking Industry**

In recent years, Creative accounting practices have been on the increase in the Nigerian banking industry as some banks present grossly exaggerated, misleading and deceptive state of financial affairs in order to attract unsuspecting investors or obtain undeserved accounting based rewards. It is evident that the extent of window dressing of financial statements in Nigeria has greatly violated all known ethical standards of the accounting and auditing profession. The list of cases linked to creative accounting practices is on the rise as more corporate bodies in Nigeria are being investigated. The recent change of board members in Cadbury Plc, Nigeria was as a result of doctoring of accounts to cover up certain inadequacies and unscrupulous deals perpetuated by the management. Likewise, the corporate failures of most Nigerian bank Chief Executive Officers and investigations into their activities by the Anti- graft agency, Economic and Financial Crimes Commission (EFCC) are largely due to fraudulent financial reporting. In 2009, the Central bank of Nigeria (CBN) sacked five (5) Bank managing directors and Executive Directors for mismanagement and alleged fraud. This has affected the stability and growth of the Nigerian financial system since some of the said banks are no longer operational; Intercontinental bank, Oceanic Bank, and Fin Bank. It is therefore arguable that the practice of creative accounting is inimical to the continual growth of the Nigerian financial system.

In 2013, the House of Representatives Committee on Finance accused commercial banks in the country of sundry sharp practices, including tax evasion, non remittance of government revenue and outright falsification of their accounts. In a report released on the 25<sup>th</sup> of August 2013, the committee said it had uncovered a lot of discrepancies in the data submitted to it by the banks including the outright refusal to present documentary evidence of revenue remittances, blank violations of existing laws, self exemption from existing rules, false declaration and manipulation of financial information. Preliminary findings showed that the published audited accounts of some

banks were at variance with the figures the banks submitted to the committee during investigation. It was then revealed that many banks blatantly engage in the creative accounting technique of inflating their operating costs to reduce exposure to taxes. In other words, over the years, the Nigerian government lost billions of naira in fraudulent and under hand dealings corruptly designed by some banks to evade taxes. The effect of this large scale corruption on the nation's economy is unquantifiable.

Further, some banks also created exemption rules for themselves in total disregard for the provisions of extant tax laws, particular violations of the stamp duty, withholding tax and value added tax (VAT) laws. There are also many cases of late remittances or outright failure to remit money collected on behalf of government. This study therefore examines the reasons and impact of creative accounting practices on the Nigerian banking industry. In the light of the findings from this study, measures to curb the practice of Creative accounting in the Nigerian banking sector will be suggested.

### **1.3 Justification of the Study**

Previous studies on creative accounting mainly focused on its impact on investors' decisions in the stock market without highlighting the reasons for such practices. More so, most of these studies were foreign and not reflective of the Nigerian situation. On the other hand, the few indigenous studies on the concept were on areas like the stock market, companies and business entities. This study therefore will contribute significantly to the existing body of knowledge as it attempts empirical examination of creative accounting practices in the Nigerian banking industry.

### **1.4 Objectives of the Study**

1. To examine the motives behind the practice of creative accounting in the Nigerian banking industry.
2. To determine whether creative accounting has contributed to banks' distress in Nigeria.
3. To adduce measures that can curb the practice of creative accounting in the Nigerian banking industry.

### **1.5 Research Questions**

1. What are the motives behind the practice of creative accounting in the Nigerian banking industry?
2. To what extent has creative accounting contributed to banks' distress in Nigeria?
3. What measures can curb the practice of creative accounting in the Nigerian banking industry?

## **2. RESEARCH METHODOLOGY AND MATERIAL**

### **2.1 Source of Data Collection and Statistical Tools**

Primary source of data was used in this study through the aid of administered questionnaire to bank managers and accountants of five commercial banks at Ajeromi Ifelodun Local Government Area, Olodi Area, Lagos State, Nigeria. The judgmental sampling technique was employed in drawing a population size of fifty eight respondents. The banks studied were First Bank, Guarantee Trust Bank, Access Bank and Sterling Bank. Using the Taro Yamane's sampling size determination approach a sample size of 50 respondents was deemed appropriate (see Yamane, 1967). However, 46 out of 50 administered questionnaires were returned. Also, the statistical tools used in this study include: Kruskal-Wallis test and multiple bar chart.

## **3. DATA ANALYSIS AND RESULT**

### **3.1 Kruskal-Wallis Test on Major reason for Creative Accounting Practice in Nigerian banking Industry**

$H_{00}$ : The major reason for creative accounting practices in the Nigerian banking industry is not to inflate the operating costs to reduce exposure to taxes.

$H_{10}$ : The major reason for creative accounting practices in the Nigerian banking industry is to inflate the operating costs to reduce exposure to taxes.

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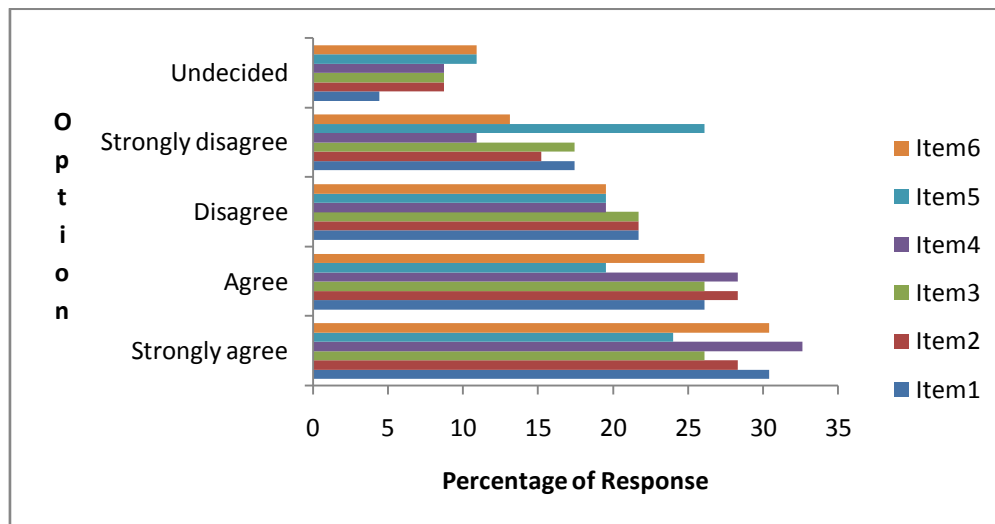
**Table 1. Ranks**

	Option	N	Mean Rank
Response	1.00	6	3.67
	2.00	6	11.00
	3.00	6	15.25
	4.00	6	21.92
	5.00	6	25.67
	Total	30	

Strong agree= 5, Agree= 4, Disagree= 3, Strongly disagree= 2, Undecided= 1

**Table . Test Statistics<sup>a,b</sup>**

	Response
Chi-Square	23.842
df	4
Asymp. Sig.	.000
a. Kruskal Wallis Test	
b. Grouping Variable: Option	



**Figure 1. Percentage Distribution on Major reasons for Creative Accounting Practice in Nigeria Banking Industry**

### 3.2 Kruskal-Wallis Test on effect of Creative Accounting on Banks' Distress in Nigeria

H<sub>01</sub>: Creative accounting has no significant effect on banks distress in Nigeria

H<sub>11</sub>: Creative accounting has significant effect on banks distress in Nigeria

**Table 3. Ranks**

	Option	N	Mean Rank
Response1	1.00	5	3.10
	2.00	5	9.20
	3.00	5	13.60
	4.00	5	19.50
	5.00	5	19.60
	Total	25	

Strong agree= 5, Agree= 4, Disagree= 3, Strongly disagree= 2, Undecided= 1

**Table 4.** *Test Statistics<sup>a,b</sup>*

	Response
Chi-Square	18.483
df	4
Asymp. Sig.	.001
a. Kruskal Wallis Test	
b. Grouping Variable: Option	

### 3.3 Kruskal-Wallis Test on Whether Certain Measures Can Curb the Practice of Creative Accounting

H<sub>02</sub>: Certain measures cannot curb the practice of creative accounting

H<sub>12</sub>: Certain measures can curb the practice of creative accounting

**Table 5.** *Ranks*

	Option	N	Mean Rank
Response	1.00	5	3.90
	2.00	5	8.70
	3.00	5	11.40
	4.00	5	18.70
	5.00	5	22.30
	Total	25	

Strong agree= 5, Agree= 4, Disagree= 3, Strongly disagree= 2, Undecided= 1

**Table 6.** *Test Statistics<sup>a,b</sup>*

	Response
Chi-Square	20.859
df	4
Asymp. Sig.	.000
a. Kruskal Wallis Test	
b. Grouping Variable: Option	

## 4. DISCUSSION

The result of the analysis obtained in section 3.1 (see Table 1) showed that option 5 (strongly agree) has the highest mean rank (mean rank= 25.67) and this implies that majority of the respondents strongly agreed that major reason for creative accounting practices in the Nigerian banking industry is to inflate the operating costs thereby reducing exposure to taxes. Also, from the result obtained in Table 2 it was found that major reason for creative accounting practices in the Nigerian banking industry is to inflate the operating costs to reduce exposure to taxes since the Chi-Square test statistic value obtained was 23.84 and a p-value of 0.00 which falls on the rejection region of the hypothesis. Hence, the null hypothesis was rejected since the p-value= 0.00 <  $\alpha = 0.05$ , assuming a 95% confidence interval.

The graphical expression in Figure 1 showed that greater percentage of the respondents strongly agreed that Item 4, Item6 and Item1 are the major reasons for creative accounting practice in the Nigerian banking industry. It was observed that majority of the respondents agreed that Item4, Item2, Item6, Item3 and Item1 are the major reasons for creative accounting practice in the Nigerian banking industry while greater percentage strongly disagreed that Item5 is a major reasons for creative accounting practice in the Nigerian banking industry. In summary it was found that Item 6, Item4, Item1 and Item3 are the major reasons for creative accounting practice in the Nigerian banking industry. This implies that the major reasons for creative accounting practice in the Nigerian banking industry are: (a) to help maintain or boost the share price by

reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend (Item6), (b) to inflate the amount of operating costs in order to reduce exposure to taxes (Item4), (c) to report a steady trend of growth in profit, rather than slow volatile profits with a series of dramatic rises and falls (Item1) and (d) to effect changes in accounting policies in order to discourage findings faults in the company's accounting system.

The result of the analysis obtained in section 3.2 (see Table 3) showed that option 5 (strongly agree) has the highest mean rank (mean rank= 19.60) and this implies that majority of the respondents strongly agreed that creative accounting has significant effect on banks distress in Nigeria. Also, from Table 4 it was found that creative accounting has significant effect on banks distress in Nigeria since the Chi-Square test statistic value obtained was 18.48 and a p-value of 0.00 which falls on the rejection region of the hypothesis. Hence, the null hypothesis was rejected since the p-value=  $0.00 < \alpha = 0.05$ , assuming a 95% confidence interval. This implies that creative accounting has significant effect on banks distress in Nigeria.

The result of the analysis obtained in section 3.3 (see Table 5) revealed that option 5 (strongly agree) has the highest mean rank (mean rank= 22.30) and this connotes that majority of the respondents strongly agreed that certain measures can curb the practice of creative accounting. In addition, it was found from the result obtained in Table 6 the certain measures can curb the practice of creative accounting since the result produced a Chi-square of 20.86 and a p-value of 0.00 which 95% confidence level. Hence, the null hypothesis was rejected since the p-value=  $0.00 < \alpha = 0.05$ , assuming a 95% confidence interval. This result implies that effective measures can curb the practice of creative accounting in the Nigerian banking industry.

## 5. CONCLUSION

This study examined the effect of creative accounting on the Nigerian banking industry. The result of this study reveal that the major reason for creative accounting practices in the Nigerian banking industry is to inflate the operating costs to reduce explosive to taxes. It was further found that the major reasons for creative accounting practice in the Nigerian banking industry are: (a) to help maintain or boost the share price by reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend , (b) to inflate the amount of operating costs in order to reduce exposure to taxes, (c) to report a steady trend of growth in profit, rather than slow volatile profits with a series of dramatic rises and falls and (d) to effect changes in accounting policies in order to discourage findings faults in the company's accounting system.

In addition, result showed that creative accounting has significant effect on banks distress in Nigeria. It was also revealed that effective measures can curb the practice of creative accounting in the Nigerian banking industry. (Ghosh, 2010) suggests that in detecting and preventing creative accounting, the following concepts must be considered: Nonrecurring accounting shenanigans (e.g. "nonrecurring items"), Pro Forma earnings, spot the habitual users of nonrecurring items, divide the figures by sales and obtain percentages to see trend, and use Nonrecurring expense ratios. Furthermore, corporate governance can play role to reduce the risks of investors and show true and fair view of financial reporting. There are some choices in current accounting rules under International accounting standards that allow managers some choice in determining methods of measurement and criteria for recognition of various financial reporting elements.

Financial report should be audited by an independent to reduce the information risk and to enhance perceived integrity. Based on the findings of the present study the following recommendation were made: (a) creative accounting should be considered a serious crime and accounting bodies and other regulatory authorities need to adopt strict measures to stop these practices and duly punish the offenders; (b) accountants in Nigeria banks and other sectors in general, should hold high ethical standards and maintain integrity in all their professional dealings. They need to ensure that the accounting profession rests on ethical principles and value, commanding national and international respect, stopping the unscrupulous practice of creative accounting; (c) this study advocates for the introduction of forensic accounting practice which can serve as an investigative function and experts witnessing in the Nigerian banking industry.

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## Appendix

Sample of Questionnaire

## Section A

What is the major motive behind the practice of creative accounting in Nigerian banks?

S/No.	Question	SA	A	D	SD	U
1	To report a steady trend of growth in profits, rather than slow volatile profits with a series of dramatic rises and fall					
2	To manipulate profits to suit earlier forecast made					
3	To effect changes in accounting policies in order to discourage finding faults in the company's accounting system					
4	To inflate the amount of operating costs in order to reduce exposure to taxes					



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5	To delay the release of information to the market, thereby enhancing the opportunity to benefit from inside knowledge in the case of insider dealing in company shares					
6	To help maintain or boost the share price by reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend					

### Section B

The following factors are responsible for bank's distress in Nigeria?

S/No.	Question	SA	A	D	SD	U
7	Insider lending					
8	Lending at high rates to borrowers in the high risk segments of the credit market					
9	Macro-economic instability					
10	Liquidity support and prudential regulation					
11	The practice of creative accounting and fraudulent financial reporting					

### Section C

The following measures will curb the practice of creative accounting

S/No.	Question	SA	A	D	SD	U
12	Accounting principles and rules should be streamlined in order to reduce the diversities of professional judgment in financial reporting					
13	Accounting bodies, Auditors and Regulatory Agencies ensuring and enforcing consistency in the use of accounting policies					
14	Legislating forensic accounting in all listed companies					
15	Accounting bodies should continue to make pronouncements that border on discouraging creative accounting activities					
16	Regulatory agencies of the financial sector should increase penalties and sanctions for directors caught in the practice of creative accounting and other fraudulent practices					