Creative Accounting: A Threat to Corporate Survival of Firms in Nigeria

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ABSTRACT

This study examined creative accounting as it affects survival of corporate firms in Nigeria. To effectively carry out this study income smoothing, window dressing and choice of accounting policies were used as proxies of creative accounting (independence variable) and corporate survival as dependent variable. The researcher was motivated to study this title due to incessant stagnation, liquidation and collapse of public business organizations in Nigeria suspected to be caused by poor management of resources. The study adopted a descriptive survey and data were gathered primarily using a well-structured questionnaire. Data analysis was done using arithmetic mean while hypothesis were tested using chi-square(x^2*) analytical tool. It was discovered that income smoothing, window dressing as well as changes in accounting policy. Significantly and negatively affected corporate survival of business firms in Nigeria. This implies that instead of perpetual existence or survival of such companies, they dwindle, stagnate, liquidate and finally collapse. It therefore recommends that accounting and government regulatory bodies should step up proper monitoring tools to effectively monitor the activities of the preparers of financial accounts and management to rise to the expectations of investors and other user of accounting report.*

KEY WORDS: *Creative accounting, Corporate survival, Income smoothing, Window dressing Accounting policy.*

INTRODUCTION

The aim of accounting is to communicate accounting information and facts about business activities, of companies or business organizations usually quantified in monetary terms to interested users. This is done as it is a language of business in uniform language and style in line with accounting concepts and conventions, international financial reporting standard (IFRS), international accounting standard (IAS) and company laws. The preparers of these accounts expect the users to rely on them to keep the various existing relationships going and as well establish new ones. However, various categories of accounting information users had suffered different aspects and levels of disappointments in relying on information that turned out unreliable as a result of creative accounting practices. This is evident in most Nigeria public business organizations or companies such as banks and industries. However it is pertinent to note that existence of survival, growth of any corporate body highly depends on the ability to survive in a competitive business environment (Adeniran, Afonja and Olaitan 2021). Besides, business activities in Nigeria is known today to operate under great risk, uncertainties and intense competition. Thus organizations intending to survive will employ reasonable techniques otherwise they will encounter failure. Creative accounting refers to 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 thereby amounting to deception (Osazev 2012). To carry out this practice, creative accounting techniques like income or profit smoothing, earnings management, window dressing, capitalizing expenses as well as changes in accounting policies or estimates can be used (Olayinka and Adekola, 2021). Conventional accounting practices allow different policies and professional judgments to be used to manipulate accounting information in order to boost company image at the expenses or detriment of the users and future of corporate entities .According to Radu (2013), creative accounting enables to allow through legal norms alteration of the financial fact of an entity through techniques, options and lack of restraints. This it does contrary to specifications of international accounting standard (IAS) which captured the general purpose of financial statements and objectives to include: provision of information about the financial position of companies, its performance activities and cash flows that are useful to a wide range of users in making economic decisions.

In furtherance, Ibenichuka and Ihendinihu (2012) contends that “creative accounting” is the transformation of financial accounting figures from what they actually are to what preparers desire by taking advantage of existing rules and or ignoring some or all of them”. The resultant effect is corporate failure, a monumental problem bedeviling business community, globally and Nigeria inclusive (Essien, Edem, Ibanichuka, Ironkweand Egbe, 2021). Evidences can be draw from public government owned companies which is the tripod of this study. Management in supportive collaboration with accounting in the various companies to prepare and present nonfactual data about their business operations using available loopholes to keep the business going thereby leading to corporate failure.

The purpose of this creative accounting may be personal instead of general as preparers or management may use it to cover their weaknesses in financial administration of the business, non business skill as they may not major in business management because their appointment is politically influenced or to cut their own share of the national cake, am opportunity long awaited and hardly to come by after then. These are few among the reasons why economic development and growth of the nation is still at the cradle.

Corporate failure occurs on a result of destinations of company’s operations leading to inability to reap sufficient profit or revenue to pay the business expenses. This undermines the integrity of preparers of accounting reports, leds to loss of confidence on auditors, analysts as well as government regulations (Elaigwu, Audu and Abdullahi, 2020).

Statement of the problem

Corporate businesses are legal entities separately existing from their owners, can make profit, taxed and legally liable. That is to say a company corporate is incorporated under an act, vested with a corporate personality independence of its members and has a perpetual succession and common seal. Its existence depends on a number of managerial factors such as good leadership, effective communication, employee involvements, performance measures, team work, adaptability to changes, training, organization structure etc. Among the key factors is financial performance measure instituted to account for progress of its activities. Preparation of financial statement to show a time and fair view of the financial transaction is often challenging as sometimes it doesn't show anticipated outcome of the managers. As a result of this they may resort to creative accounting to make a formidable corporate existence.

In Nigeria, evidences have shown that creative accounting techniques used in various occasions for various reasons instead of buying perpetual succession and growth brings corporate failure. Against this backdrop is this study to detect actually whether creative accounting is a threat to company existence or survival in Nigeria.

Objectives of the study

The broad objective of this study is to determine whether creative accounting is actually a threat to cooperate existence or survival.

While the specific objectives are:

1. To determine the effect of income smoothing an corporate survival of firms in Nigeria
2. To examine the effect window dressing on corporate survival of firms in Nigeria
3. To investigate the effect of changes in accounting policies on corporate survival of firms in Nigeria

Statement of Hypotheses

$H0_{1:}$ There is no significant and negative effect of income smoothing on corporate survival of firms in Nigeria

$H0_{2:}$ There is no significant and negative effect of window dressing on corporate survival of firms in Nigeria

$H0_{3:}$ There is no significant and negative effect of changes in accounting policies on corporate Survival of firms in Nigeria

LITERATURE REVIEW

2.1 **Conceptual review**

Creative Accounting

Creative accounting depicts the use of legal methods of recording financial information but do not show clearly the real situation making the company seem more successful than it really represents. In the studies of Hamna and Emmanuel (2017) creative accounting can also be called "Earnings management" an act that acknowledge the rules of standard accounting practices but deviate from the spirit of those rules in terms of morality but immoral in terms of misguiding investors. It is entirely an excessive compliance and application of innovative ways recognizing income, assets, liabilities and the intent to influence users in interpreting and using the desired results. Besides, Ijeoma and Aronu (2013) refers to creative accounting as aggressive use of choices available under accounting rules to present the most fathening view of a company possibly in its financial statements. They added that it involves pushing accounting principles to the limits of their flexibility or beyond so as to improve the actual position of the financial statements. To Idris, Kehinde, Ajemunigbohun and Gabriel (2012) it simply depicts accounting techniques which allows distortion and manipulation of financial information in order to present an better financial picture by either increasing or decreasing the profit, by giving a misleading appearance of the capital size or structure and by concealing relevant information from existing and potential investors.

Olayinka and Adekoya (2018) affirm that creative accounting occurs for a number of reasons. Among them are: desire to understate profits to reduce tax, Liabilities to report steady trend of growth in profits to ensure job protection for directors, management and other employees and need to ensure compliance with loan covenants or to polity bankers.

Corporate Survival

Corporate survival according to Graham, Narasimhniwe and Bradley (2004) is a situation of keeping business operation for certain amount of time especially during crisis situation like financial crisis. A company that have achieved corporate survival have undergone through a corporate life cycle such as startup stage, growth stage, establishment stage and maturity stage. In addition, factors such as debt policy, credit worthiness, corporate governance and investment are key to business solvency, and valuation hence corporate survival depends on effective corporate performance.

Conversely, corporate or business failure explains a situation where a business entity is faced with going concern issues that cause its inability to continue as a business unit; but collapses or winds up its operation.

In the works of Olaymka and Adekoya (2018) factors responsible for corporate failure ranges from poor management, loss of major client, declining sales, loss of market share, poor business and financial planning, inability to retain key staff and to the practice of earnings management

Income Smoothing

Income smoothing is also known as profit smoothing. According to Olayinka and Adekola (2020) income smoothing refers to a way of manipulating reported profits by recognizing (usually artificial assets or liabilities and releasing them to profit or loss as required. They emphasized that is the process of deflating reported profits of a business in a good period and deferring them to loss-making periods in a bid to portray a “stable income stream” over the years. Matching concept makes this possible and investors prefer it as it purports a stable, strong and growing business. LYU, Yuen and Zhang (2017) assert that income smoothing is a process where managers of corporate entities use accounting techniques to level out an unleveled and fluctuations of earnings from one accounting period to the next using accounting principles. Managers undertake this process in pursuance of personal goals such as bonus compensational plans and targets. Closing gaps created by managerial incompetence and in meeting up expectations, particularly where there is divergence of actual income from shareholders and other stakeholders’ expectations (Hamm, Jung and Lee 2018).

Window Dressing

Window dressing aspect of creative accounting describes when managers undertake measures to make financial statements of their operating organization look attractive than they actually are in order to mislead shareholders and investor. Olayinka and Adekola (2021) affirm that window dressing involves adjustment of financial statements of business organization with a view of achieving maximum effect on the financial position at a particular date. The adjustment could be on the statement of financial position or profit and loss account. They added that businesses adopt window dressing for various reasons such as: to protect an enterprise from takeovers, to improve share valuations by posting higher profits causing them to approve accounts at annual general meetings without much interrogation, to enhance revenue from takeovers, to retain institutional investors support and to retain or gain lines of credit

Changes in Accounting Policies:

It is pertinent to note that statement of accounting standard (SAS 8) permits companies and preparers of financial statements to choose any policy from among the number of accounting policies that is best suitable for their operations. By this, a company can revalue assets (change from cost model to revaluation model to improve gearing or change the way it depreciates assets to improve profit like changing from straight line method to reducing balanced method.

Theoretical Framework

Agency Theory

This study draws from agency theory by Jensen and Meckling (1976) which explains the relationship that exist between business owners and their managers. That is to say that owners of the business (Stakeholders) do not manage the business themselves but higher the services of agents who then report back to them. The separation of ownership from management of modern corporations provides the context for the function of agency theory. Emphatically, agency relation remains a catalyst to corporate existence as the owners of business units most often may not have the technical know-how to run their organizations. That occurs to employ agent(s) who possess the requisite skills to pilot the affair though as mankind may observe unethical codes that may lead to the corporate failure.

Ethical Theory

The study was anchored on ethical theory as propounded by Immanuel Kantin in 18th century (Ojomoladeam, Adejuwon (2020). Generally, firms prefer reporting a constant trend of growth in profit of businesses than showing volatile profits with fluctuations. This is acceptable and achieved through making moderate provisions for liabilities and against assets values in good years improving reported profits and reduced later in bad years. The profounder of this theory argue that the measure is against “Short termism” of judging investment based on the obtained yield in the immediate following years. It as well avoids raising expectations so high in good years that the firm experiences inability to deliver what is required subsequently. Based on this, it positioned to say that if a trading conditions of a business are volatile investors are owed the right to know and that income smoothing may conceal long term changes in the trend of profit (Ojomolade and Adejuwon (2020). It also explains that it also avoids increase in expectation in good years that the company cannot deliver as required. It therefore argued that if trading conditions of a business are volatile the investors have the right to be aware and that income smoothing hope to conceal long-term changes observable in the profit trend.

Empirical Review

Several studies have been conducted in relation to creative accounting and corporate failure by different scholars at various times covering certain scope to infer justifiably on the context. Among them are reviewed below:

Ademran, Afanja and Olaitan (2021) examined the practical business strategies of Kariggiton company for survival and growth in a competitive business environment in Nigeria. A case research design and purposive sampling techniques was adopted for sample size selection in the company. Data were generated through questionnaire, analyzed descriptively with the necessary tools and the chi-square. It was unveiled that quality control and modern technology have significant effect on corporate survival and growth of Kariggiton company in Nigeria.

Nwaobia, Kwarbai and Fregene (2019) carried out a research on earnings management and corporate survival of listed manufacturing companies in Nigeria. Out of 66 manufacturing companies listed on the Nigerian stock exchange as at 31st December, 2016, a sample of thirty (30) companies with complete data were purposively selected. The data gathered were secondary from published financial statement as it was ex-post facto design. The data were analyzed using descriptive and inferential (OLS) regression statistics. Earnings management proxied by discretionary accruals jointly with corporate governance proxies showed significant effect on corporate survival.

Rodriguez et al (2016) in the documented evidence of the study on the negative impact of discretionary accounting practices on corporate image and long-run survival of companies noted a negative link between family control and earnings management. This is as a result of highly concentrated ownership. They concluded that family firms have more incentive in controlling and monitoring managerial decisions, earnings management behavior and the firm's subsequent loss reputation. To avoid this creative accounting technique is considered as an alternative.

Olaynika and Adekola (2021) undertook a research on corporate failure in Nigeria: A resultant effect of creative accounting. Data were gathered primarily using a well-structured questionnaire and analyzed using analysis of variance (ANOVA) and chart analysis. The findings indicated that creative accounting has a significant impact on corporate failure in Nigeria. It was concluded that creative accounting is unethical and offers a formidable challenge to the quality of financial reporting and the going concern status of corporate entities in Nigeria.

Essien, Edem, Ibianichuka, Emmanuel, Ironkwe and Egbe (2021) investigated creative accounting methods and corporate failure in Nigeria. Primary data were gathered through structured questionnaire. While Analysis was done using regression analysis. It was unveiled that creative accounting has a positive effect on corporate failure specifically income smoothing, accounting policy choice and artificial transactions.

Iajuzie, Eyisi and Lormbagah (2020) on their own research on "impact of creative accounting techniques on firms financial performance reporting in Nigeria". Data were gathered through a well-structured questionnaire, administered among samples of certified auditors and accounting instructors in some universities. Descriptive and inferential statistics were the tools used to generalize the result and conclude the findings. It was unveiled that creative accounting techniques used by management negatively affect the reliability of financial reporting.

Elaigwu, Audu, and Abdullahi (2020) studied creative accounting and corporate failure in the Nigeria financial reporting. A survey method of research design was adopted. Data were gathered from a sample of managers and accountants of commercial banks and analyzed using mean scores and tested hypotheses with a Z-test statistical tool. it was discovered that creative accounting practices have a significant effect on corporate failures in Nigeria. As such it was recommended that the issue of creative accounting should not be neglected but taken as criminal offence to be dealt with by accounting bodies and regulatory authorities.

Manukaji (2018) researched on corporate governance and income smoothing in the Nigeria Deposit money banks; adopted ex-post factor research design to analyze the data from 2012-2016 using multiple regression analysis. It suggested that income smoothing by deposit money banks largely depends on the corporate governance mechanisms such as ownership concentration, and existence of audit committee. She then concludes that corporate governance has significant relationship with income smoothing in Nigerian deposit money banks.

Shuaibu and Muhammad (2019) undertook a study on the impact of income smoothing on the financial performance of listed deposit money banks in Nigeria. Data were extracted from the annual report and final accounts of eight (8) sampled banks between 2012 and 2017. It was analyzed using ordinary least square. It therefore revealed that income smoothing have negative and insignificant impacts on financial performance of deposit money banks in Nigeria.

Imagbe and Okoughenu (2021) examined the relationship between income smoothing and financial performance of firms listed on Nigerian stock exchange after the adoption of IFRS. Data were extracted from annual report and accounts of the sampled companies from 2013 -2017. Analysis was based on Pearson correlation and fixed effect regression. It unveiled that income smoothing had a positive and significant relationship with financial performance measured by return on Asset (ROA).

Patnaik, Litt, and Das (2014) studied “Creative accounting and window dressing: An empirical analysis”. A survey for empirical analysis was applied. It indicated that window dressing practices are prevalent in majority of corporate entities.

Ogazevbaru (2012) conducted a study on creative accounting and firm’s market value in Nigeria seeking to find the practice of creative accounting in Nigeria and if such practices enhance firm’s value. Data gathered were primary by means of structured questionnaire. Hypotheses were tested using chi-square tool. It exposed that the practice obtains in Nigeria and positively affects firm’s value which can impact on its share price.

In addition, Ojemolade and Adejuwon (2020) explored creative accounting and corporate failure in Nigeria using quantitative descriptive survey method. Data collected was analyzed using descriptive analysis and Pearson coefficient or correlation at 5% significant level. The result exposed that creative accounting cause corporate failure if fraudulently used. This explains that investors suffered as a result of doctored financial statements of corporations as they relied on the provided financial information as a result of symmetric information. It then recommends that they should be coordination and uniformity among the financial standards and laws as well as permissible flexibility punishable by regulatory authorities and accounting bodies.

Gap: The results of the empirical review indicated that creative accounting practices causes corporate failure of firms in Nigeria. This paper is to detect if creative accounting denied can retain the confidence of investors and/or stakeholders and foster viable corporate existence/survival.

METHODOLOGY

The study adopted a descriptive research survey design as the data gathered were primary. The population of the study was infinite and as such the researcher used Topman sample size determination formula to determine sample size among accounting practitioners and auditors in tertiary institutions in Ebonyi State, Nigeria.

Thus; n = $\frac{Z^2PQ}{e^2}$

Where: n = sample size

Z = zee score at 95% level of confidence

p = Assumed success rate

Q = Assumed error margin

substituted as follows:

n = 1.96

p = 0.9

Q = 0.1

e = 5% $(0.05)^2$

n = $\frac{(1.97)^2\,(0.9)(0.1)}{(0.05)^2}$ $(1.9)^2$ (0.9)(0.1)

n = $\frac{3.8416x0.09}{0.0025}$

n = $\frac{0.345744}{0.0025}$

n = 138.2976

n = 138

Well structured questionnaire were designed to elicit responses from the one hundred and thirty eight (138) number of the respondents. Before its use, it was administered to a qualified expert in accounting and auditing profession to lend credence to the quality and as well ensure pacificity and reliability. The outcome indicates high and uncontroversial reliability. It was on a modified four (4) point Likert Scale of strongly agree, agree, disagree and strongly disagree rated 4, 3, 2 and 1 respectively. The data collected were analyzed using arithmetic means while hypotheses were tested using chi-square (x^2) test.

Analysis of Responses:

Data from modified 4 point Likert scale was presented and analyzed using Arithmetic mean.

Table1: Effect of income smoothing on corporate existence/survival of firms in Nigeria

	SA	A	D	SD	TOTAL
Manipulates reported profits	32	51	26	29	138
	128	153	52	29	362

Portrays stable income stream	41	30	52	15	138
	164	153	104	15	436
Matching concept makes it possible	27	36	28	47	138
	108	108	56	42	319
May pursue personal goals	44	37	26	32	138
	176	111	52	32	371

Source: Researcher's field work (2022)

Table 2: Effect of window dressing on corporate existence/survival of firms in Nigeria

	SA	A	D	SD	TOTAL
Makes financial statement attractive	43 172	40 120	31 62	24 24	138 378
Adjustment takes place in profit and loss account or statement of financial position	45 180	48 144	24 48	21 21	138 393
It protects firms from takeovers/competition	37 148	53 159	33 66	15 15	138 388
Improves share violation	44 176	46 138	25 50	23 23	138 387
Retains investors confidence and support	56 224	50 150	28 56	4 4	138 434

Source: Researcher's field work (2022)

Table3: Effect of changes in accounting policies on corporate existence survival of firms in Nigeria

	SA	A	D	SD	TOTAL
Adopts change of policy from among others suitable to company operations	63 252	51 153	18 36	6 6	138 447
Can change from cost model to revaluation model	64 256	58 174	14 28	2 2	138 460
Improves gearing or change the depreciation method to improve profits	36 144	49 147	23 46	30 130	138

Source: Researchers field work (2022)

Testing of Hypotheses

Hypothesis 1

HO_1: Income smoothing have no significant and negative effect on corporate existence/survival of firms in Nigeria.

Table 4: Testing on whether income smoothing have significant and negative effect on corporate

existence

o	e	o-e	$(o-e)^2$	$\frac{(o-e)^2}{e}$
362	372	-10	100	0.3
436	372	64	4096	11.0
319	372	-53	2809	7.6
371	372	-1	1	0.0
1488				18.9

Source: Researcher's computation (2022)

Result: x^2cal= 18.9; x^2tab =3.841

x^2cal > x^2tab. therefore, null hypothesis is rejected which means that income smoothing have significant and negative relationship with corporate existence/survival of firms in Nigeria.

Hypothesis 2

$^{HO}2$: window dressing have no significant and negative effect on corporate existence/survival of firms in Nigeria.

Table 5: Testing on whether window dressing have no significant and negative effect on corporate existence

o	e	o-e	$(o-e)^2$	$\frac{(o-e)^2}{e}$
378	396	-18	324	0.8
393	396	-3	9	0.0
388	396	-8	64	0.2
387	396	-9	81	0.2
434	396	38	1444	3.6
1980				4.8

Source: Researcher's computation (2022)

Result : x^2 cal = 4.8; x^2tab =3.841

x^2cal > x^2tab.null hypothesis is rejected and alternative hypothesis is accepted. it depicts that window dressing have significant and negative effect on corporate existence/survival of firms in Nigeria.

Hypothesis 3

$^{HO}3$: Changes in a accounting policies have no significant and negative effect on corporate existence/survival of firms in Nigeria.

Table 6: Testing on whether change in accounting policy have no significant and negative effect on corporate existence

o	e	o-e	$(o-e)^2$	$\frac{(o-e)^2}{e}$
447	425	22	484	51.1

460	425	35	1225	2.9
367	425	-58	3364	7.9
1274				11.9

Source: Researcher's computation (2022)

Result: x^2cal =11.9; x^2tab =3.841

x^2cal>x^2tab null hypothesis is rejected while alternative hypothesis is accepted. It therefore explains that changes in accounting policies have significant and negative effect on corporate existence/survival of firms in Nigeria.

Discussion of findings

The proxies of creative accounting (income smoothing, window dressing and change in accounting policies) revealed significant and negative impact on corporate existence of firms in Nigeria. This indicates that though they may be advantages in the short run the after effect in the long run may be disfavourable as it may lead to distrust loss of confidence and finally corporate collapse. Corroboratively Elaigwu and Audu, and Abdullah (2020) added that creative accounting has a negative impact on corporate survival. This according to them, is that in several instance it has led to the failure of several commercial banks and company in other industries emphatically they assert that several companies worldwide indulged in creative accounting for a number of years hiding their deficiencies and operative in effectiveness but died at the end. Also, Ajuzieeyisi and Lormbagah (2022) opine that creative accounting techniques applied by management have a negative effect on the reliability of financial reporting. This depicts that negative effect discourages patronage and companies that lack commensurate patronage compared with economic challenges of their period hardly survives.

Conclusion

The evidences of the analysis and result of hypotheses tested confirmed significant and negative effect of creative accounting on corporate existence of business firms in Nigeria. The study therefore concludes that creative accounting is unethical and offers a formidable challenge detrimental to corporate survival as a going concern entity in Nigeria as confidence is doubtful.

Recommendations

As a results of findings of this research recommends were made as follows:

1. That management and financial accounting preparers should avoid income smoothing as it doesn't show exactly the product of their effective operations
2. That the management and financial accounting preparers should not uphold the technique of window dressing since it attracts loss of confidence on financial reports.
3. That accounting regulatory authorities should as a matter of fact monitor keenly the policies adopted by companies to certify timelines, situation and accuracy of implementation.

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