Accounting Estimates and Misstatements in Financial Reports in Nigeria: A Survey of Small and Medium Enterprises

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Abstract
The risk of material misstatements in financial statements generally impair their fair presentation and credibility. These have serious negative implications on the reliability of financial decisions made by users of such reports; since financial statements portray financial position and business performance of entities; and forms an inevitable source for decision making. This study assesses the influence of accounting estimates on misstatements in financial reports of Small and Medium Enterprises in Nigeria. Specifically, we examined the impacts of depreciation estimates, impairment loss, inventory estimates and goodwill estimates on financial reports. The population was Small and Medium Enterprises in Nigeria. The study employed the survey research design. Data were mainly collected primarily through the questionnaire and was analyzed using descriptive statistics and regression technique via SPSS statistical software. Findings revealed that wrong estimates may lead to, but are not the only causes of misstatements in financial reports. It was recommended that accountants should adhere to the provisions of accounting standards when making estimates; in order to reduce material errors or misstatements in financial reports, which they prepare for public consumption.

***Keywords**: Accounting Estimates, Mis-statements, Depreciation Estimates, Inventory Estimates, Impairments Estimates, Goodwill Estimates, Financial reports,*

1.0 INTRODUCTION

Financial reports are stewardship reports prepared by management aimed at depicting the financial status of the entity; in terms of performance, financial position and changes in financial position. They are accountability instruments by management; and are meant to serve as "road maps" for assessment by the users (Nangih ,2018).

An objective and reliable accounting information is a prerequisite for proper decision making processes, since they portray financial position and business performance of the entity. Rogers and Blenko (2006) posit that making good decisions and making them happen quickly are the hallmarks of high-performing organizations. Accordingly, for financial reports to be relevant, reliable, understandable, and accurate, all the numbers must be factual while the estimates and disclosures made by management must be reasonable, realistic and reliably based on the underlying accounting frameworks or standards.

Accounting estimates are approximations of the amounts of business transactions for which there are no precise basis of measurement. Estimates are used in accrual based accounting to make the financial statements to show a true and fair view. They are usually employed in historical financial statements to measure the effects of past business transactions or events, or the present status of an asset or liability. They are subjective and relative; therefore, prone to management bias.

On the other hand, a misstatement in financial statements occurs when an item has not been treated correctly in the financial reports, meaning that the applicable financial reporting framework, such as International Financial Reporting Standard, were not properly applied. According to *accountingtool.com*, 'a misstatement is the difference between the required amount, classification, presentation, or disclosure of a financial statement line item and what is actually reported in order to achieve a fair presentation, as per the applicable accounting framework'. Hence, a misstatement is considered to be material when the user of a set of financial statements alters his economic decisions as a result'. It may arise due to errors or mistakes, but sometimes could be done intentionally to window dress or achieve a particular purpose by the preparers. Some examples of misstatements, commonly found include: situations of deliberate or willful recognition of incorrect amounts in the financial statements, wrong measurements of assets and liabilities, deliberate over or under statements of certain expenses such as impairment losses, depreciation estimates, provision for doubtful debts etc.

The major risk in relying on accounting reports is the misuse of accounting judgements and estimates by financial statements preparers, which may be either too conservative or too aggressive. Though debatable, it is obvious that accounting judgements and accounting estimates are interlinked; to the extent that both are highly subjective and have significant effects on an entity's financial reports. In fact, it could be argued that the risk of material misstatements in financial reports could be largely caused by the use of wrong accounting estimates, either intentionally or erroneously by the preparers. Such may lead to the overstatement of income or the understatement of expenses in future periods. Accordingly, all accounting estimates represented in financial statements should be measured by applying international or national financial reporting standards to make it relevant, reliable, understandable, and comparable as well as devoid of material misstatements that can be deceptive and/or alter the views of the users. This is further supported by the International Accounting Standards Board (IASB), which admits that "to a large extent, financial reports are based on estimates, judgements and models rather than being exact depictions" (IFRS Foundation, 2015).

Making estimates implies certain level of subjectivity to the extent that two different estimates for an item can result with different accounting information. Consequently, these affect the measurement of an entity's financial position and performance; and by extension, so can the financial statements users' business decisions. For this reason, the regulators (including auditors) have always emphasized the importance of disclosures regarding critical accounting estimates for items such as goodwill, assets impairments recognition, amounts of assets revaluation, assets carrying value, estimation of useful lives of noncurrent assets and depreciation estimates, since they significantly affect the way profits are determined and users' perception and their financial decisions made based on such misstated reports. These have attracted the attention of some accounting researchers recently.

1.1 Statement of the Problem

Estimates, disclosures and management judgements form most part of financial statements. These estimates arguably improve the quality of financial information by providing managers the platform to convey to stakeholders forward-looking, inside information. However, the quality of financial information is sometimes distorted or compromised by preparers through the incessant cases of managements' misuse of accounting estimates and judgements through manipulation of financial data. Given the prevalence of several accounting estimates in accounting reports, the Financial Reporting Council of Nigeria (FRCN) has variously insisted that the disclose of information relating to accounting estimates should be clear, reliable and fair to ensure faithful representation of information portrayed in financial statements in Nigeria. This has prompted a lot of attention; and forms one of the most crucial issues to contemporary accounting researchers. Various studies have been carried out on accounting estimates and financial reporting quality. For Instance, Nnah (2017), Akenbor and Kiabel (2014), Ayunku and Eweke (2019), all carried out studies on accounting estimates and financial reporting quality; using different sectors listed on the Nigerian Stock Exchange. However, we are not aware of any study that has looked at the interconnectedness between accounting estimates and misstatements of financial reports in Nigeria among SMEs. This study was meant to fill that gap, and indicates our point of departure. Specifically, we empirically the impacts of provision for depreciation, estimated assets impairment loss, estimated inventory value, estimated assets carrying value and estimated goodwill amount on misstatements in financial reports of SMEs.

2.0 REVIEW OF RELATED LITERATURE

2.1.1 Mis-statements in Financial Reports

Financial statements show company's financial position and business performance. To ensure that the financial statements of an entity are in consonance with financial reporting standards, directors are required to make reliable estimates, judgements and assumptions that affect the numbers reported in their financial reports and the explanatory notes. Since individual judgements are subjective by their nature, the results of their estimations may not be the same. Misstatements in financial statements therefore exists where there are material misrepresentations in financials, either deliberately or otherwise. It implies the use of wrong estimates/judgements, which affect the faithful representation of the underlying facts, thereby altering the users 'views. Aptly, a misstated financial statement lacks relevance, faithful representation, understandability, comparability, neutrality and above all, credibility.

2.1.2 Accounting Estimates and Dimensions

Accounting estimates are approximations made in financial statements usually based on historical evidence and the judgment of the accountant or management. Estimates are based on subjective as well as objective factors. Accounting standards represent an important source of accounting estimates. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* describes a change in an accounting estimate as ''an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities''. Making accounting estimates is a very complex process that connotes obtaining of all required information about the topic. Examples of estimates commonly found in financial statements are: provision for depreciation, impairment loss estimates, inventory value estimate, goodwill estimate, and estimated useful life of assets, etc. This study discusses the following proxies of accounting estimates;

Depreciation Estimate: Depreciation is, by definition, is the systematic allocation of the depreciable amount of the asset over its estimated useful life (IASB 2010). It is an estimation of financial requirements, since the only way to know for sure how much an asset has depreciated is to have it valued periodically. Most small businesses use the straight-line method of depreciation, which assumes that an asset will depreciate in value by the same amount each year over a specific period. This estimate may not reflect the asset's real-life value, because certain assets, like vehicles, tend to depreciate at a faster rate in the early years of their useful life. IAS 16-Property, Plant and Equipment provides for the reducing balance of depreciation estimation, as an alternative to the straight line method. However, both methods are based on estimates, and will producing differing results.

Impairment Loss Estimate: Assets impairment is governed by the provisions of IAS 36 *Impairments*. An asset is said to be impaired when it loses its value. IAS 36 defines impairment loss as the amount in which the asset's (or cash generating unit's) carrying amount exceeds its recoverable amount. Entities are encouraged to carry out impairment review or tests whenever they suspect or there is an evidence that impairment has occurred. If such exists, entities are expected to estimate the value of the recoverable amount of the assets and then write down the value of the assets to that amount. Such impairment loss is written off to the profit or loss statement. This requires management judgements or estimates; and if not properly estimated may distort the relevance and faithful representation of information contained in the financial statements.

Closing Inventory Estimate: According to the provisions of IAS 2-*Inventories*, inventory should be measured at the lower of costs and net realizable value. It also specifies that management can choose between the first in first out or weighted average cost methods in inventory costing. It then implies that management has alternatives and can estimate the value to be assigned to closing or opening inventory using either of the methods specified in the standard. Ultimately, the resultant effects will not be the same, depending on the method adopted and especially where there are deliberate manipulations.

Goodwill Estimate: Purchased goodwill (arising from a business combination) is the excess of the purchases consideration over and above the net assets of the entity as at a particular date. It could also mean the excess of the market value over and above the book value of the firm. In practice, these are done by way of estimates. The resultant effect is that it depends on individual accountant's judgement, experience, discretion etc. In theory, goodwill lasts forever, but it might not have the same value to the company from one year to the next. Hence the amounts of goodwill included in the financial statements could impact the value of the entity's assets; and therefore, should be carefully and properly estimated to avoid misstatements; as that can impair the truth and fairness of the financial information.

2.2 Theoretical Review

This study was anchored on the Stakeholders' theory. The theory was developed by Freeman (1983), By stakeholders we mean those who stand to benefit directly or indirectly from entity or the information provided in the financial statements of the entity. Bassey et al (2013) opined that "Stakeholders are groups or persons, which are influenced by the corporate activities or which affect the entity either directly or indirectly". The basic assumption of the stakeholders' theory is that the firm's growth is a function of the successful management of its relationship with its stakeholders. It posits that the proper management of its stakeholders could affect the firm's performance. The stakeholders' model therefore advocates for an increased level of environmental awareness among business enterprises to the needs of its stakeholders.

The relevance of the stakeholders to this study is that entities should be mindful of the needs of its stakeholders the credibility or otherwise of the information content of financial statements of the firm could impact negatively or otherwise, on the decisions taken by the users of the entity's financials (being the stakeholders).

2.3 Empirical Review

There are limited empirical studies which assess the role of accounting estimates in the reduction of material misstatements in financial reports. However, there are quite a number of studies that examined the impact of information disclosures on financial statements quality.
Nnah (2017) examined the impact of accounting estimates on financial reporting quality of manufacturing companies in Nigeria. Employing the questionnaire as a source of data collection, which was tested by multi-correlation analysis method, it was found out that accounting estimates had significant relationship with financial reporting quality. Putri and Suputra (2019) investigated the effect of disclosure of financial report and managerial ability on earnings management in Indonesia from 2012 to 2016. Using a sample of 375 companies and audit quality as a moderating variable, the study – which was based on 33 voluntary disclosure items, found that disclosure of financial report has an effect on earnings management, but had no significant effect to managerial ability. Nangih (2018) examined the nexus between creative accounting practices and financial statements quality of oil and gas servicing companies in Port Harcourt metropolis in Nigeria. Using survey design approach, he found out that creative accounting practices significantly and negatively affected the quality of information presented in financial reports by oil and gas serving companies in Nigeria. It was recommended that preparers and regulators of financial reports should ensure strict adherence to the provisions of International Financial Reporting Standards, to reduce cases of creative accounting practices in financial statements in Nigeria. Kanakriyah, (2016) examined the impact of voluntary disclosure on the quality of accounting information according to users' perspective in Jordan. Using the semi-structured interview, which was conducted on 12 respondents drawn from 6 groups of accounting information users (financial managers, financial analysts, auditors, academics, creditors and investors), the paper found a strong effect of voluntary disclosure on the quality of accounting information. It was concluded that voluntary disclosure was vital in enhancing the economic decisions process. Akenbor and Kiabel (2014) investigated the relationship between accounting estimates and financial reporting of hospitality companies in Nigeria. It was discovered that accounting estimates had significant relationship with credibility of financial reports. Ahmed et al (2014) looked at influence of provisions, being a proxy for accounting estimates, in and earnings management the banking industry. It was concluded that there was a positive relationship between provision for loan losses and earnings management. Bhat et al. (2006) show that regulations favoring disclosure improve the accuracy of forecasts, and Hope (2003) shows a positive link between the quality of financial forecasts and the degree of disclosure of annual reports and a positive links between the quality of financial forecasts and the degree of enforcement of accountings standards. Disclosure also creates shareholder value by allowing a firm to reduce the cost of its capital. The majority of the studies show this positive impact (Botosan, 1997 or Cheng et al., 2006). Some studies arrive at less conclusive results. For instance, Botosan (2000) finds that an increased disclosure only benefits to companies that are followed by few financial analysts. Khurana et al. (2006) posit that a more transparent firm reduces its agency costs and is thus able to resort more easily to external financing. They in fact exhibit a positive link between corporate disclosure and growth in their data, which tends to prove the point.

3.0 METHODOLOGY

This study adopts the survey design. The target population was small and medium enterprises in Nigeria. In order to avoid accessibility difficulty, data was obtained by means of purposive sampling technique. In all, 125 respondents were selected, consisting of knowledgeable senior/management staff, accountants, auditors and tax consultants of some SMEs within the metropolis. A five-point Likert Scale structured questionnaire was used to elicit responses from the respondents. The result of their responses were analysed using the descriptive, correlation and regression techniques. The reliability of the instrument was determined using the Cronbach's Alpha, which revealed coefficients of .645, .712, .635, .589 and .715 FRPM, PRDP, IPML, INVE and GDWL sub items, respectively.

Model Specification

In a bid to capture the impact of accounting estimates on material misstatements in financial reports of SMEs in Nigeria, we developed a functional relationship in line with the dependent (financial reporting misstatements) and independent variables (proxied by provision for depreciation estimate, impairment loss, inventory value estimate and goodwill estimate) as:
FRPM =f (PRDP + IPML+ INVE+ GDWL).
This is further restated in a regression model thus:
$FRPM = a0 + a_1PRDP + a_2IPML + a_3INVE + a_4GDWE + U_t$.
Where, FRPM= Financial reporting misstatements, PRDP= Provision for Depreciation Estimates, IPML= Impairment loss, INVE= Inventory estimate, GDWE= Goodwill estimate, and U= Error Term

4.0 ANALYSIS AND INTERPRETATION

The Descriptive statistics on the items raised as well as their correlations are presented in tables 1 and 2.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
PRDP	125	2.33	4.33	3.9801	.49626
IPML	125	2.33	4.67	4.0640	.52875
INVE	125	2.00	4.67	4.0684	.55687
GDWL	125	2.33	4.67	3.8808	.51832
FFRP	125	2.67	4.67	4.0817	.46820
Valid N (list wise)	125				

Source: *Author's Computation Using SPSS 23*

The outcomes of the descriptive statistics of the mean and the standard deviation for each variable of influence of accounting estimates and mis-statements in financial reporting quality of SMEs in Nigeria are provided in Table 1. The table indicates that provision for depreciation estimates (PRDP) on faithful representation had a mean and standard deviation of 3.9801 and 0.49626 respectively. The results of Impairment loss estimates (IPML) on Faithful representation (FFRP) reported a mean of 4.0640 and a standard deviation of 0.52875 and has a maximum and minimum figure ranging from 4.67 to 2.33. In the same vein, the mean and standard deviation of Inventory estimates (INVE) are 4.0684 and 0.55687 respectively with figures ranging from 4.67 maximum to 2.00 minimum. Goodwill estimates (GDWL) has a mean of 3.8808 and a standard deviation of 0.51832. The figure spread ranges from a maximum of 4.67 to a minimum of 2.33. Finally, Faithful representation (FFRP) reported a mean of 4.0817 and a standard deviation of 0.46820 with figures ranging from 4.67 to 2.67.

Table 2: Correlations

		PRDP	IPML	INVE	GDWE	FRPM
PRDP	Pearson Correlation	1	.247**	-.194*	-.045	.394**
	Sig. (2-tailed)		.006	.030	.619	.000
	N	125	125	125	125	125

IPML	Pearson Correlation	.247**	1	-.191*	.276**	-.069
	Sig. (2-tailed)	.006		.033	.002	.447
	N	125	125	125	125	125
INVE	Pearson Correlation	-.194*	-.191*	1	-.243**	-.012
	Sig. (2-tailed)	.030	.033		.006	.896
	N	125	125	125	125	125
GDWE	Pearson Correlation	-.045	.276**	-.243**	1	.139
	Sig. (2-tailed)	.619	.002	.006		.123
	N	125	125	125	125	125
FRPM	Pearson Correlation	.394**	-.069	-.012	.139	1
	Sig. (2-tailed)	.000	.447	.896	.123	
	N	125	125	125	125	125

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).
Source: Researcher's Computation using SPSS 23

Table 3: Regression Result Summary

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	-.316	.908		-.348	.728
	PRDP	.695	.121	.483	5.741	.000
	IPML	-.290	.105	-.238	-2.760	.007
	INVE	.136	.118	.097	1.153	.251
	GDWE	.418	.144	.249	2.914	.004
	R = .490	R^2 = .240	Adjusted R^2 = .215	F = 9.488	Sig. = .000	

a. Dependent Variable: FRPM
Source: Researcher's Computation using SPSS 23

Discussion of Findings

From the results in table 2, the Pearson Correlation results indicate positive correlations between PRDP as well as GDWL and FRPM while INVE and IPML are negatively correlated with FRPM. However, only PRDP is significantly correlated with FRPM. This suggests that provision for depreciation and goodwill estimates are likely to increase financial reporting misstatements. In **table 3**, the R statistic of .490 indicates that the independent variables have weak joint positive correlations with FRPM. The adjusted R^2 statistics of .215 reveals that the independent variables explain only 21.5% of the variations in the dependent variable. Thus, accounting estimates do not purely account for financial misstatements. The F statistic of 4.88, which is significant at 1% level, is also an indication that the model has a good fit.

Furthermore, the results of the t-statistics reveal that all the independent variables have positive relationships with financial reporting misstatements except PRDP, which are equally significant except INVE. The PRDP of 5.741, which is significant at 1% indicates that as depreciation estimates increases, financial reporting misstatements are likely to increase. The reason for this is that depreciation is one of those estimates that is very difficult to estimate. This is because most firms don not carry out actual periodic value assessment of their noncurrent assets but such estimates rely mainly on book value estimation. This finding agrees with the works of Akenbor and Kiabel (2014) who discovered that accounting estimates influenced significantly the quality of financial statements quality of companies in the hospitality industry in Nigeria.

In the case of IPML, it is found to be negative and significant also at 1% level of significance. The negative relationship between impairment estimations and financial reporting misstatements. This implies that impairment estimations are unlikely to cause misstatements, which is due to the fact that the basis for such estimates are more realistic and can be more likely ascertained than those of depreciation and many others. Again, this is in agreement with the findings of Nnah (2017) who found out that accounting estimates influenced financial reporting quality of selected manufacturing companies in Nigeria

More so, the t-statistic of 1.15 and associated p-value of .251 for INVE is also an indication that inventory estimations can increase financial misstatements, but it is not significant. The coefficient of .136 also shows that it can only constitute a small proportion of financial reporting misstatements. This is also supported by the correlation results which shows a negative correlation with FRPM. The reason is that, like impairment estimates, the basis for its estimation is more realistic and accurate. However, it positive relationship with financial misstatements is because inventory values may not reflect the obsoleteness of some of the stocks nor demurrage arising from inventory movements.

Lastly, the regression result also established that goodwill estimate has high positive effect on misstatements, given the coefficient of .418 and t-statistic of 2.91, which is also significant at 1%. The reason for this is that goodwill is also very difficult to estimate, and thus, likely to increase misstatements in the financial reports. From the, it can explain as much as 41.8% to variations in financial misstatements, which calls from more realistic basis of assumptions. This supports the findings of Ahmed et al (2014) who discovered a significant and positive correlation between accounting estimates and financial reporting quality of banks in Nigeria.

5.0 CONCLUSION AND RECOMMENDATIONS

The study examined the influence of accounting estimates on misstatements in financial statements by Small and medium enterprises. The results indicate positive correlations between depreciation estimate as well as goodwill estimates and financial misstatements while inventory estimates and impairment losses are negatively correlated with financial reporting misstatements. Thus, accounting estimates do not purely account for financial misstatements. Furthermore, the results of the t-statistics revealed that all the independent variables have positive relationships with financial reporting misstatements except Provision for depreciation estimates, indicating that as depreciation estimates increases, financial reporting misstatements are likely to increase. Lastly, the regression result also established that goodwill estimate has high positive effect on misstatements, given the coefficient of .418 and t-statistic of 2.91, which is also significant at 1%. The study concludes that the use of accounting estimates, though contribute to, but are not the only factors responsible for misstatements in financial reports of SMEs. It was therefore recommended that management should be cautious and follow the provisions of relevant accounting standards when making estimates in order not to present a fraudulent, biased and misleading financial reports; as these could have attendant negative consequences to all stakeholders when making financial decisions regarding the entity. It was also recommended that the directors should ensure other factors such as sound internal controls, strict compliance to accounting policies, compliance with other regulatory frameworks, etc are maintained to ensure their financials were reliable, relevant and faithfully represent a true and fair view of the financial position and business performance at any point in time.

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