

Creative Accounting Practice - Make or Mar Profit

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Abstract. The study looks at creative accounting practices in Nigeria with specific emphasis on its role in improving profit or otherwise. Like the tax avoidance, creative accounting, though lawful, is unethical. Though the practice often keeps companies afloat, their financial positions remain very unhealthy, with the consequences of a sudden failure, as the concept of "true and fair" is compromised. From the literature reviewed, it was discovered that managers use various creative accounting dimensions of income overstating, inventory manipulation, bad debt understatement, liabilities understating, and depreciation underreporting to manipulate the accounting figures at the detriment of the shareholders for their selfish gain. The study concluded that creative accounting improved profitability in the short run while enhancing an organisation's overall survival and ongoing concern. Thus, there is an urgent need to curb these practices with a robust legislative act that will make them unlawful by establishing a new policy framework. By intensifying its supervisory roles, NDIC and Apex Bank must strictly comply with revenue, inventory valuation, and asset depreciation accounting policies.

Keywords: Creative Accounting; Profitability; Unethical Practices; Nigeria.

INTRODUCTION

The sudden collapse of firms in the recent past has cast doubt on the quality of accounting services of the employees and the credibility and quality of work of auditors (internal and external) as accountants are being accused of succumbing to the pressure from the management to prepare and present reports suggestive of impressive performance and a clean bill of health of the organisation concerned.

Due to the pressure, accountants often tend to present an untrue position in their companies to satisfy their masters' (managers') selfishness. The author [1] observed that managers usually perpetrate unethical acts of revenue overstating, expenditures understating, assets overstating, and liabilities understating through Creative Accounting (CA) activities. Creative Accounting, even though lawful, is dishonest, as it contradicts the

main objectives of financial reporting. Even though CA practices must always be within the law and in line with the Accounting Standards, it remains unethical for it to meet that lawfulness. Therefore, these practices of Creative Accounting have been identified to include recognising fictitious revenue, aggressive capitalisation and extended amortisation policies, misreported assets and liabilities, getting creative with income statements and problems with cash flow reporting [2].

Though the practices of CA are lawful, they remain unethical, which is the primary concern of this study. Thus, any unethical act in accounting must be avoided, as it is against the main objectives of financial reporting, which may lead to severe compromises on the bank's image. Multinational companies like the energy giant ENRON, the telecommunication firm, the WorldCom and even Unilever Plc have since tasted the consequences of

manipulations of accounting records for selfish interests. The implications of any unethical act of practices in accounting and finance could have a negative and devastating impact on the overall existence of an organisation, significantly when it tarnishes its reputation and can equally prompt a sudden collapse, especially the banks. Thus, the practices might negatively affect the bank's reputation and overall survival. The practices of CA often define a massive breach of the fidelity trust between the owners and the managers. Yet, it still misleads potential investors, tax authorities, and the general public, which needs to be addressed. However, the constant eroding of public trust is equally problematic, upon which the company's success depends on its patronage for sustained turnover and operational activities. However, there remains an unanswered question relating to the practices of CA, thus demanding an accurate understanding of the practices, even as the activities are within the law and the accounting standards [2, 3]. This study aims to review how creative accounting is perpetrated and its effect on the profitability of an organisation.

Literature Review

Concept of creative accounting. Creative accounting is a phenomenon that describes an act that is permissible by the law (although unethical) in terms of manipulating accounting and financial records to make them look appealing. At the same time, in an actual sense, it is an unhealthy position, yet provided it is within the accounting standards. Such activities include revenue overstating, expenditure reduction, assets overstating, and liability understating, such as window dressing, income smoothing, cosmetic accounting, and earning management. However, these practices can never be within the accounting standards, as changes in depreciation could lead to untrue carrying down the value of a particular asset, leading to an unethical act that must be discouraged. More so, some studies in recent times [2, 4] have focused on CA and the performance of banks, while others like [5] have dwelled on CA and IFRS implementation in Nigeria and the effects on the shareholder's wealth, yet creating room for further studies, especially studies towards CA and profitability, which is the hallmark of this study.

Concept of Overstating Revenue. Revenue, income or sales volume are the basis of the success of any business venture, as it is the only soft absorber that can mitigate the impacts of expenditures to

determine a profit or loss status. Therefore, the consequences of overstating the revenues could positively affect the profit position, as the adverse effects of the expenses will be mitigated. However, these could ultimately lead to a bank's unfair financial position. Banks that indulged in these acts were found to report a jumbo profit and even pay dividends to the shareholders from a zero profit, which remains unreliable. Consequently, the "True and Fair view" principles have been highly compromised.

Concepts of Understating Bad Debt (UBD). Lousy debt or non-performing loans are those loans in the borrower's principal, and the interest repayment remains defaulted, up to a specific period as described by the CBN's classifications process, up to a complete year. The CBN's non-performing loan loss provisions stipulated that the CBN prudential guidelines must be followed to determine the banks' asset qualities to minimise bad debts and toxic assets. Therefore, these loans become lost to the bank after all efforts when they cannot be recovered. However, whenever it is understated, it might not have the same effect on the overall profits of these banks. Therefore, by understating it, profitability will likely increase.

Concept of Lowering Depreciation Charges (LDC). Like the non-performing loans, depreciation is an expense through a provision (non-allowable expenses in taxation). However, by lowering it, the overall profit figure might be increased simultaneously. According to accounting standards, there must always be consistency when applying particular depreciation methods. However, when that becomes inconsistent from one accounting period to another, it may lower it and most likely positively impact the profit.

Concept of Understating Liabilities (UL). Unlike the expenditures with debit balances, the liabilities always have credit balances, often negating the banks' total assets. Therefore, it may positively affect the banks' net assets when the liabilities are understated. Invariably, it could burden the bank whenever lowered, whereas the consequences remain there in the actual sense.

Concept of Inventory Manipulation (IM). Inventories (stocks) are one of the significant items of current assets in the Statement of Financial Position (Balance Sheet). The higher it is, the greater and better it is for the banks. However, it becomes only problematic when it has to be manipulated to make it higher than it is supposed to be. The managers could easily manipulate inventory items in

so many ways, such as inconsistencies in the treatment of the inventory valuation, overpricing the stock items, selling and repurchasing such stocks, creating artificial stock items, continuous counting and recording of obsolete stocks in the stock books of accounts and records, even as they remain outdated. Therefore, the primary aim is to portray a larger volume of total inventory inside the balance, which does not exist. Consequently, it will increase the quantum of sales/turnover as an opening stock at the beginning of the period. Any deliberate increase in the turnover volume will result in a rise in the gross profit, as the cost of sales can easily be observed.

Concept of Profitability. Every business entity has been set up to maximise profit and increase its net worth. Thus, the banking organisation is no exception, as it is equally aimed at making profits for the shareholders, maximising their wealth. Profit is the residual of turnover. It is needed to maintain, sustain and continuously improve the banks' fortunes. Increased profitability and maximisation of the shareholders' wealth have always been a focus for all banks and companies as precedence among other corporate issues like corporate social responsibilities. According to [6], shareholder wealth is the projected future earnings of the firm owners calculated in their present value, while profitability is the residual income.

Empirical Review

Many empirical studies have been conducted both within and outside Nigeria to investigate whether Creative Accounting (CA) affects organisations' corporate profitability. For instance, authors [6] conducted a study on Board Composition and Non-Performing Loans to establish the significance of CA, especially to non-performing loans. Further added, the study also considers the other bank-specific and economic indicators to review the relationship between Board attributes and CA, but none of these could direct their investigations on the impact of CA.

Similarly, [2, 3, 4] have focused the investigations on CA and the general performance of the banks, while others like [5] dwelled on CA and IFRS implementation in Nigeria and the effects on the shareholder's wealth. Conversely, [1, 2] observed that these unethical acts of revenue overstating, expenditures understating, assets overstating and liabilities understating are often being perpetrated by the managers through the activities of

(CA), even though lawful but unethical, which goes contrary to the main objectives of financial reporting, as it undermines the quality of the financial reports.

Furthermore, both [2, 3, 7] attempted to examine the various activities of CA that often impede the overall credibility of organisations and frequently render them unsafe for investments and patronage. Apart from these, the hallmark of this current study is to focus on unethical practices as they affect not only the profitability but its reputation and the chances of survival.

They similarly evaluated the contribution of creative accounting practices to the performance of deposit money banks in Nigeria. The study adopted a survey research design. A judgmental random sampling technique was employed to select four banks out of 21 deposit money banks in Nigeria. Primary data were collected from 60 chosen respondents through a stratified random sampling technique. Descriptive statistics were used to analyse hypotheses one and two, in which responses to the questionnaire using the 5-point Likert Scale were clustered into two groups. The correlation technique was adopted in the analysis of hypothesis three. The results of the studies showed that creative accounting contributes significantly to the non-financial and financial performance of banks in Nigeria. Also revealed was a high correlation between the contribution of creative accounting practices on banks' financial and non-financial performance. The research concludes that creative accounting negatively affects banks in Nigeria as decisions based on the information provided were deceptive, hence the reports of corporate collapse resulting from such actions. The study recommends, amongst others, that Accountants in the employ of organisations intending to indulge in creative accounting practice should resist and/or persuade the management by explaining in detail the implications of engaging in the act as it is unethical and gives misleading financial performance decisions.

Similarly, [3] examine the relationship between creative accounting (CA) and the reported financial performance of banks and insurance companies in Nigeria and the extent CA impacts their dividend payout ratio. Five years of economic data from 2004 to 2008 from twenty banks and insurance companies listed on the Nigerian Stock Exchange (NSE) were extracted using stratified and simple random sampling techniques. Survey data were obtained from 386 respondents purposively

selected from the chosen organisations using a researcher-designed questionnaire validated by experts and shown to have a reliability coefficient of 0.876. Correlation and regression statistical techniques were used to analyse the data. The results show that creative accounting techniques are positively associated with firm financial performance and significantly affect dividend payout (DPO), with 88% of the variations in DPO being accounted for by changes in the explanatory variables. The work concludes that the desire to showcase an impressive picture of corporate profitability by paying enhanced dividends 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.

On the contrary, investigate to bring attention to the creative accounting phenomenon. Types of creative accounting practices have been examined by comparing scandals that occurred in large companies in the last two decades. To realise this scope, the authors define the concept of creative accounting and its various forms and try to figure out why the country came into a financial crisis again, even if history taught us that the risks are substantial. They discussed the implication of creative accounting in the current economic situation because many financial enterprises have sought state support within a short period of receiving unqualified audit opinions. The research method is deductive fundamental and gives them the necessary prerequisites for future research. They believe that creative accounting practices will not disappear unless the causes which have given rise to them will disappear, too. Therefore, although driven by the intention to limit creative accounting, accounting normalisers must consider the circumstances that allow its expression under close supervision.

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CONCLUSIONS

Based on the concepts and literature reviewed, the study deduced that, even though creative accounting can help management make a profit, it has some negative consequences on the organisation's reputation and concern capability. In essence, creating accounting triggers profitability but only in the short run. However, to be precise, the image and future value of organisations engaging in creative accounting practices are at risk or in danger. The study, therefore, recommended that.

Through their supervisory role, the Apex Bank (CBN) and the Nigerian deposit insurance NDIC should evaluate the adequacy of policies around Income measurement and disclosure in the financial accounts.

Also, the NDIC should intensify monitoring and supervisory in consistently applying all the accounting policies, primarily as it affects depreciation and inventory.

The IASB, in conjunction with the NASB, should develop a framework through the CAMA that will make all forms of creative accounting unlawful and unethical to sanitise and stabilise organisations from future failures.

Global human rights groups should advocate for a complete boycott of the service of any organisation that is involved in the practices of creative accounting to discourage its continued occurrence.

There is a need for a periodic forensic audit exercise to foster the consistent application of the accounting policy by organisations with an increase in the strict enforcement of the Prudential Guidelines on non-performing loan classifications.

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