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Creative Accounting Dynamics and Financial Reporting Quality in Public Corporations in Nigeria

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ABSTRACT

The public corporations are pivotal institutions that are vehicle used by the government to lubricate an economy and engender development. As government owned entity, their activity stimulates the economy of any nation. This paper examines financial statement to investigate the extent to which creative accounting issues in such financial reports had influenced the quality of such report in the public corporations in Nigeria. The study used secondary data from ten selected public corporate entities' annual reports to rate the influence of creative accounting manipulations or otherwise on factors that influences financial reporting quality. A deductive approach using descriptive survey and inferential statistics were used to reach general conclusions based on the results from the findings. The result shows that application of standards allows for accounting preparer to use discretions given room to either positive or negative impact on financial reporting quality. The study noted that in Nigeria, the annual reports most times show positive growth while the economic reality signs show otherwise. Manipulative behaviours in financial reports in public corporations in Nigeria promotes corruption, destroys the image of the nation, public loss of confidence and negative growth trend.

KEYWORDS: *Creative Accounting, Disclosure of Revenue and Cost, Auditors' Opinion, Financial Performance, Financial Statement/ Annual Report, Compliance to Standards*

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INTRODUCTION

Financial statements are document that accounts for the performance of entities' activities or events or transactions for a specified period of time. It is generally perceived that a financial report is an actual representation of financial 'facts' in a form of accounts that is expectedly correct, reliable and objectives from an activity or a transaction or event. It must be emphasized that the correctness of the financial facts made available will depend on the source and accurate of data captured for such events or transactions. The choice of interpretation of standards, the extent of compliance, the amount of disclosure details of financial and non-financial details, and the opinion of the auditor are choices subjective to the preparer of the accounts and the auditors. The manipulation of value of financial information by accounts preparer or the auditor may not be deemed legal or illegal and without violating any financial regulations or international standards plays a very significant role in quality of financial report. The relationship between creative accounting practices and financial reporting quality have been described by several authors in varied ways. The works of Daniel Liberto on Creative Accounting, reviewed by Thomas Brock updated in Investopedia November 2020 noted that although creative accounting may have followed the required regulations but in actual is a deviation from what the standards are set to achieve. He explained that where financial managers using accounting standards to take advantage of a loophole to either cover up facts or put up a better image of a corporation. Some author thinks creative accounting is presentation of a fake financial position while others say it is a gimmick in financial reports to promote market value of stock and market share (Mulford and Comiskey, 2002).

The Nigerian public sector is adjudged to have suffered series of setbacks majorly as a result of ineffective and inefficient management of the affairs of its public enterprises which have failed to deliver on the purposes for which they were established (Esu & Inyang, 2009). A good system of public accountability allows for efficiency in management of public resources. Accountability is the bed rock of wealth creation, the base for building a strong governance structure in any government institutions or well-organized public corporations (Iyoha & Oyerinde, 2009). In the corporate public sector, quality financial reporting has been well established taking advantage of creative accounting reporting. The recent economic recession in Nigeria is a pointer indicating the need for high-quality financial reporting in the public sector. According to Heiling (2011), governments needed to maintain quality accounting and reporting systems that accurately reflects on their financial risks. Quality financial reporting in the public sector is the framework for financial and economic policies formulating, effective coordination of the affairs of government, financial operations, and management control from an informed financial position.

The importance of financial reporting in the public sector cannot be undermined due to its contribution to achieving political and economic stability. Financial reporting ensures prudence, reduce waste, and improve the quality of governance by ensuring spending efficiency, effectiveness and transparency especially spending on health care, education, transport, and infrastructure. Financial reports ensure compliance to accounting principles, enhance fiscal discipline, unite system efficiencies, improved control over scarce resources and provide more relevant information for users 'decision making.

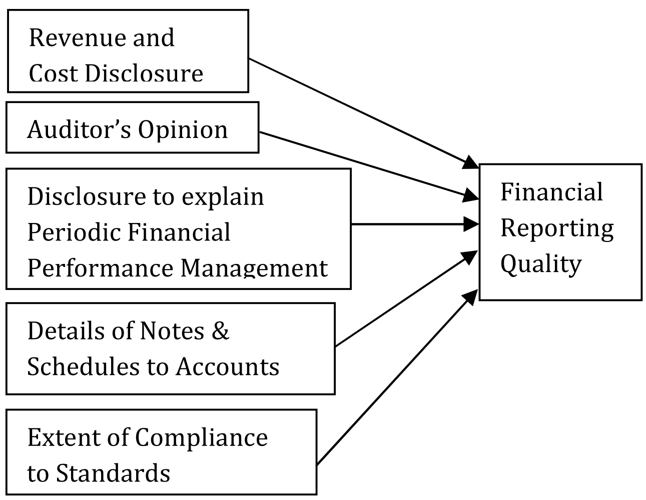
This study identified public corporations in Nigeria with a mix of commercial entity that generates revenue and incurred cost for Nigerian but are non-profit oriented government owned entities with similar traits to the private counterparts.The objective is to find out any unethical creative accounting practices that will on the outside present a sound financial position but on the inside a negative outlook.

SOME THEORETICAL CONCEPTS AND ISSUES

This study was guide by several theories that provided theoretical arguments on some key concepts of the work. This study settles in with the Public Interest Theory; Stakeholder's Theory associated with Ansoff in 1965 in alignment with the objective of public corporations examined; and the Positive Accounting Theory associated with Watts and Zimmerman in 1978 and 1986 respectively which will help the public corporations plan into the future.

This study considers the public interest theory in the context of accounting regulation. It provides analysis of context within which the setters of accounting standards operate. The establishment of accounting standard and the act of standard setting is political, not just economical. The stakeholders' theory attempts to provide explanation for the structure and operations of a corporation with regards to accounting information provided to meets the needs of stakeholders (Omoro, Adudu, & Okiro, 2014). Zimmerman and Watts (1978) attempt to explain in their paper towards a positive theory of determination of accounting standards, that management's attitude towards accounting standards will be influenced by the effect the standards will have on the cash flow of a corporation. For several hypothetical reasons, fund managers may decide to choose particular accounting method over the other with the objectives of the corporation in view.

Figure 1: Theoretical Framework



EMPERICAL REVIEW

In 2010, Christiaens, Van-Cauwenberge, Rommel, and Soederberg gave an insight into IPSAS framework on implementing Whole Government Accounts(WGA). In their paper, they argued that IPSAS reflects a business-like perspective which can result in certain definite improvements such as reporting a fair view. The study also further noted that it may be however assume a position where it is difficult to capture specific governmental features, particularly when considering statistical bases of financial reporting. In the face of the public sector landscape, IPSAS is still relatively new general and accounting reform which has introduced a new public management system. Bringing a business-like view into government, the traditional cash accounting had to be changed to the accrual-based accounting system. It is expected there will be an increase in financial transparency and accountability in government where the concept of consolidation is taken over and weaknesses and strength of the accrual accounting in government are worked upon (Christiaens & Rommel, 2008).The Whole Government Accounts (WGA) issue is aimed at improving entities managerial efficiency, accountability, and macro-economic policy-making process (Chow, Humphrey, and Moll, 2007). The objectives of IPSAS as a framework take into consideration the need for:

1. Transparency
2. A better understanding of the governmental market and non-market activities and
3. Understanding of the relationship between financial statements vs. statistical bases of financial reporting

Watts and Zimmerman (1990) in their literature noted that creative accounting can positively influence a corporation when accounting practices and guidelines provided are positively adhered to. The flexibility of the use of accounting regulations or standards can be a tool for addressing critical situations in a corporation (Shah, Butt,& Tariq, 2011). The practice of reporting revenue and concealing cost incurred for the period allows public corporation to report high revenue generation for the period. Heally and Wahlen (1998) with DuCharme, Malatesta and Sefcik, (2004) supported this assertion in their study. In the study they postulated that increasing revenue income by accounting for expected income now and accruing cost for the future allows the corporation report higher revenue income than it should be or otherwise. This was earlier postulated by Beidlemen (1973) when he submitted that corporations' write-offs are more when new management takes over blaming the immediate past management and relieving future charges but retaining overstated accruals to achieve earnings goals in the near future. Management self interest to meet government target either for revenue target or any other pressure can lead to this kind of report. This could further lead to wrong economic decisions, deceit of users of such financial information and stakeholders. Grasso, Patricia and Richard in their article titled 'the ethics of earnings management: perceptions after Sarbanes-Oxley' in 2009 agreed that when creative accounting practices misleads or deceives financial information users, it becomes illegal, unethical and immoral practice.

Accounts handlers and auditors are very important in improving financial reporting quality especially in the public corporations. Study has shown that where Auditors and external directors or supervision are involved in the preparation of financial report, creative accounting practices are minimized (Yadav, 2013). External professional involvement in a financial report increases report credibility and public confidence. External auditors improves creative accounting practices by reducing negative tendencies and increase positive ones thereby ensuring accuracy, efficiency and reducing fraudulent acts (Kassem, 2012).

Manipulative behaviours are encouraged most times by decision makers of public corporation such as the Directors and Head of Ministries, Departments and Agencies. Management of agencies in problem, under pressure to meet targets and financial fraud to cover sometimes indulges in unethical practices of creative accounting to hide financial manipulations or mislead regulatory authorities (Diana & Beatrice, 2010; and Amat & Gowthorpe, 2004). Asuquo (2011) in his study believed that business entities are surrounded with various situations and depending on the situation, operators of financial statements indulges in creative accounting practices to meet the situation demand.

METHODOLOGY

Most research conducted on related topic are targeted at the private profit oriented firms and not public corporation as this. This research work uses the secondary data and relied on qualitative method of analysis. The simple Ordinary Least Square regression was used using the Statistical Package for the Social Sciences (SPSS) software. This was used specifically to determine the impact of creative accounting practices on financial reporting quality.

HYPOTHESIS:

H1: The extent of disclosure of revenue and cost has significant impact on financial reporting quality

H2: Auditor's opinion has significant impact on financial reporting quality

H3: Disclosure to explain periodic financial performance management has significant impact on financial reporting quality

H4: Details of notes and schedules to accounts has significant impact on financial reporting quality

H5: The extent of compliance to standards has significant impact on financial reporting quality

MODEL SPECIFICATION

FRQ = f(Creative Accounting Practices) ……………………..(i)

Where FRQ is Financial Reporting Quality and f(Creative Accounting practices is the function of selected variable items that can influence financial reporting quality. Therefore,

FRQ = f(RevCos, AudOpt, PerMgt, NoSchA, ComStd,…..μ_t)..(ii)

Where:
RevCos = Extent of disclosure of Revenue and Cost,
AudOpt = Auditor's Opinion,
PerMgt = Disclosure to explain periodic Financial Performance Management,
NoSchA = Details of Notes and Schedules to Accounts,
ComStd = Extent of Compliance to Standards

RESULT PRESENTATION AND DISCUSSION

Table 1: An Overview of Operational Indicators Analyzed and Validating the Characteristics Strength

INDICATORS	ANNUAL REPORT BASED ON IPSAS 2017-2019						ANNUAL REPORT BASED ON OLD ACCOUNTING STANDARD 2014 - 2016					
Items	Mean	SD	Median	Min	Max	Remarks	Mean	SD	Median	Min	Max	Remarks
Extent of Disclosure to which Revenue covers the Cost of Services provided in the Report	4.70	0.483	5.00	4	5	High	3.20	0.34	3.50	3	5	Moderate
Auditor's Opinion: Qualified / Unqualified Reports	4.50	.527	4.50	4	5	High	3.01	0.44	3.50	2	5	Moderate
Details of information disclosed to explain periodic financial performance measurement	2.80	1.814	2.50	1	5	Low	1.19	1.32	2.00	1	5	Low
Notes and Schedules to Accounts	3.60	1.506	4.00	1	5	Moderate	2.90	1.08	3.00	3	5	Low
Extent of Compliance to Standards in the Report	3.60	1.265	4.00	2	5	Moderate	2.27	1.20	3.00	2	5	Low

The overall score on each of all 5 operational items utilized in the study were tested as index quality variable tools for assessment of the level of influences it has on financial reporting quality. A total of ten public corporations in Nigeria of revenue generation and cost incurring institutions were selected and used. Sixty Annual Reports were examined consisting of 30 for 2014 to 2016 as pre-IPSAS Old Accounting Standard Annual Reports and 2017 – 2019 as IPSAS-Based Annual Reports which was carefully selected across all relevant public sector corporations in Nigeria.

Table 1 presents an overview of operational indicators showing mean, median and strength of indicators. The result showed that all items of operational characteristics that determine financial reporting quality are all above average mean score of 2.5 except for periodic performance disclose having a score of 1.19 and compliance to standards of 2.27 in the old accounting standard-based reports. Extent of Disclosure to which Revenue covers the Cost of Services provided in the Report had a differential mean score and standard deviation of 1.50 ±0.14 in the IPSAS Annual Report above that of the Old Accounting-based Annual Report. Auditor's Opinion of Qualified / Unqualified Reports in IPSAS based report also record higher mean score and standard deviation of 1.49 ±0.09 above the Old Standard.

Table 2A: Old Accounting Standards Annual Report Result for 2014 - 2016

DEPENDANT VARIABLE FRQ – Financial Reporting Quality							
PREDICTORS: f(Creative Accounting items)							
MODEL SUMMARY							
MODEL	R	R^2	Adj. R^2	Std. Error of the Estimate	DW	Std. Dev.	Mean
REGRESSION	0.706	0.671	0.615	3.698	0.607	1.368	2.514

ANOVA					
MODEL	Sum of Squares	df	Mean square	F	Significance
REGRESSION	17.1807	1	17.1807	12.474	.0001

CO- EFFICIENTS						
UNSTANDARDIZED CO-EFFICEINTS				STANDARDIZED CO-EFFICEINTS	t	Significance
MODEL	B	Pvalue	STD. ERROR	Beta		
(CONSTANT)	2.979	0.056	0.351	0.706	2.232	0.0001
RevCos	0.761	0.213				
AudOpt	0.523	0.143				
PerMgt	0.415	0.332				
NoSchA	0.722	0.054				
ComStd	0.520	0.102				
MODEL	REGRESSION LINE					
REGRESSION	$FRQ = \beta_0 + \beta_1 RevCos + \beta_2 AudOpt + \beta_3 PerMgt + \beta_4 NoSchA + \beta_5 ComStd + \mu_t$					

Table 2B: IPSAS Based Annual Report Result for 2017 - 2019

DEPENDANT VARIABLE FRQ – Financial Reporting Quality							
PREDICTORS: f(Creative Accounting items)							
MODEL SUMMARY							
MODEL	R	R^2	Adj. R^2	Std. Error of the Estimate	DW	Std. Dev.	Mean
REGRESSION	0.857	0.815	0.706	2.573	0.679	2.112	3.844

ANOVA					
MODEL	Sum of Squares	df	Mean square	F	Significance
REGRESSION	40.1662	1	40.1662	14.819	.0001

CO- EFFICIENTS						
UNSTANDARDIZED CO-EFFICEINTS				STANDARDIZED CO-EFFICEINTS	t	Significance
MODEL	B	Pvalue	STD. ERROR	Beta		
(CONSTANT)	3.841	0.029	0.305	0.857	2.573	0.0001
RevCos	0.665	0.048				
AudOpt	0.836	0.157				
PerMgt	0.582	0.277				
NoSchA	0.567	0.087				
ComStd	0.695	0.093				
MODEL	REGRESSION LINE					
REGRESSION	$FRQ = \beta_0 + \beta_1 RevCos + \beta_2 AudOpt + \beta_3 PerMgt + \beta_4 NoSchA + \beta_5 ComStd + \mu_t$					

The estimated OLS equation (i) from table 2:

a) Using the Old Accounting Standard-Based Annual Report 2014 - 2016

$FRQ_{t-1} = 2.979 + 0.761RevCos_{t-1} + 0.523AudOpt_{t-1} + 0.415PerMgt_{t-1} + 0.722NoSchA_{t-1} + 0.520ComStd + \mu$

Pvalue 0.056 0.213 0.143 0.332 0.054 0.102

$R = 0.706$, $R_2 = 0.671$, Adj. $R^2 = 0.615$ t-Stat = 2.232, F-Change = 12.474, SE (μ) = 0.351

b) Using the IPSAS –Based Annual Report 2017 - 2019

$FRQ_t = 3.841 + 0.665RevCos_t + 0.863AudOpt_t + 0.582PerMgt_t + 0.567NoSchA_t + 0.695ComStd + \mu$

Pvalue 0.029 0.048 0.157 0.277 0.087 0.093

$R = 0.857$, $R_2 = 0.815$, Adj. $R^2 = 0.706$, t-Stat = 2.573, F-Change = 14.819, SE (μ) = 0.305

The regression result of the linear function shows that the co-efficient of the revenue - cost function, auditors' opinion, periodic financial performance management, notes and schedules to accounts, and compliance to standards are significantly positive for both pre-IPSAS (R = 0.706, R2 = 0.671) and post-IPSAS (R= 0.857, R2 = 0.815) reporting regime. Unit increase in Financial Reporting Quality in public corporation will lead to unit increase in RevCos by 0.76, AudOpt by 0.523, PerMgt 0.415, NoSchA 0.722 and ComStd 0.520 for the old accounting standard reporting period. This also applies to the IPSAS based annual report result. However, comparing the two regimes, the co-efficient differential of revenue-cost function and notes & schedules to accounts fell by 0.096 and 0.155 respectively. The implications is that there is a significant complimentary relationship between revenue – cost function and notes and schedules to account as fall in one will lead to the fall in the other. Creative accounting practices can be adopted to either increase revenue or reduce cost to achieve management goals.

On the other hand, the co-efficient AudOpt, PerMgt and ComStd improved by 034, 0.167 and 0.175 respectively in the IPSAS regime above that of the Old Accounting Standard. The implication is that a favorable audit opinion aligns with good financial performance management and compliance to reporting standards.

Result Findings:

Changes in revenue-cost function and auditors' opinion have significant impact on financial reporting quality. Revenue-cost function and auditors' opinion are key qualitative operational characteristics and are fundamental to corporations' financial reporting quality. A positive shift in revenue will improve the financial position of the corporation positively and a shift in cost will lead to deficit. Also, an unqualified audit opinion improves stakeholders' and public confidence. Audit opinion has the ability to improve public trust and goodwill which invariably will result to a positive shift in corporation's financial position.

Changes in periodic financial performance management, notes and schedules to accounts, and compliance to standards are enhancing operational characteristics that will support the financial position of the corporation. A negative shift in qualitative operational characteristics will lead to negative shift in enhancing operational characteristics. The enhancing operational measures further strengthen the quality of financial reports generated in public corporations.

CONCLUSIONS AND RECOMMENDATIONS

Management is expected to appoint Consultants and External Auditors that have integrity to checkmate or reduce the negative creative accounting practices. Attentions should be given to source documents to ensure accurate, reliable and actual financial data are captured in financial records.
Management must also encourage post audit review and implement recommendations made to them by the auditors.

The issues of having sound financial position in public corporations in Nigeria on paper and poor economic output/realities must be checked and reduced to the barest minimum. This will improve control and reduce corruption tendency by management.

The study showed that adoption of IPSAS based report is better than the use of the Old Accounting Standard based report. From the study, Auditors' Opinion, Periodic Financial Performance Management, and Compliance to Standards improve significant the Financial Reporting Quality. The study will recommend IPSAS based reporting pattern for Financial Reporting Quality improvement.

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