Creative Accounting and Implication for Dividend Payout of Companies in the Financial Sub-Sector of Nigerian Economy

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Abstract

This study examines the relationship between creative accounting (CA) and reported financial performance of banks and insurance companies in Nigeria, and the extent CA impacts on their dividend payout ratio. Five year financial data from 2004-2008 of twenty banks and insurance companies listed on the Nigerian Stock Exchange (NSE) were extracted using the stratified and simple random sampling techniques. Survey data were obtained from 386 respondents purposively selected from the chosen organizations using researcher-designed questionnaire validated by experts and shown to have a reliability coefficient of 0.876. Correlation and regression statistical techniques were used in analyzing the data. The results show that creative accounting techniques are positively associated with firm financial performance and have significant effect on 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 impressive picture of corporate profitability through payment of enhanced dividend 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.

Keywords: *creative accounting, financial reporting, accounting standards, earnings management, financial performance.*

1. Introduction

The basic objective of financial reporting is to provide information about an enterprise that is useful to a wide range of users in making economic decisions. However, the validity of this objective is being questioned by many users of corporate financial reports because of the probable effects of creative accounting on information contents of such reports.

The term 'creative accounting' has become a topical issue of late, particularly, since the collapse of Enron in the USA. The wave of corporate scandals in other companies in USA (WorldCom, Tyco, Xerox and HealthSouth) and in Europe, (Ahold, Vivendi, Lernout and Hauspie) had caused more anxiety in the corporate world. Nigeria is not isolated from the growing wave of financial scandal.

In Enron Corp for example, profits were inflated over a number of years through the use of special purpose entities. Gains were recognized on transactions that had no real economic

substance. Loans were equally reported as deferred revenue instead of borrowings, enabling the company to report the proceeds received as operating instead of financing cash flow. Thus liabilities were kept off the balance sheet.

A report of creative accounting scandal in African Petroleum PLC slated for privatization in 2001 showed that the financial statements of the company did not fairly present the company's financial position. A number of transactions, including substantial loans, were omitted from the financial statements. This fact was discovered when a due diligence audit was done in preparation for privatizing the company (Oyejide and Soyibo, 2001).

In November 2006, an accounting scandal in Cadbury Nigeria Plc also raised more questions than answers about creative accounting. An independent investigation of the company's financial statements confirmed a significant and deliberate overstatement of the company's financial position through inflated stock figures over a number of years, and this compelled the company to diminish its reserve by making a one-time exceptional charge in 2006 of between N13 billion and N15billion (Itsueli, 2006).

Further, in March 2010, Alloway reported the findings of a bankruptcy examiner on the collapse of Lehman Brothers, an American Investment Bank that used creative accounting techniques tagged "Repo 105" and "Repo 108" generally called "Repo 105" to massage its leverage ratios. The bank used 'repo' transactions to temporarily remove securities inventory from its balance sheet and created a materially misleading picture of the firm's financial condition in 2007 and 2008. Over $50 billion of liabilities were thus removed from the balance sheet effectively reducing its leverage ratios. These are only a few instances where creative accounting has been used to massage financial performance of corporate entities with threats to firm survival.

The collapse of a firm has always inflicted its stakeholders and society with negative marks resulting in varying degrees of negative growths in major indices of organizational performance. Corporate distress/failure not only inflicts damage to the value of the firm (and by extension, reducing stakeholders wealth), but the other interest groups (employees, creditors, customers, management) too do have their dose of the bitter pill. It is spiral and infectious, and may have a crippling effect on other economic entities and the economy as a whole. Creative accounting thus, offers a formidable challenge to the accounting profession, the regulatory authorities and the entire business community (Ibanichuka and Ihendinihu, 2009).

The negative connotation now being bandied about creative accounting notwithstanding, the term is not new in accounting parlance. It has been variously described sometimes as 'aggressive' or "innovative" accounting or "earnings management". A number of companies engage in creative accounting because of the accounting discretion window provided by flexible accounting rules. These rules by the regulatory authorities attempt to ensure that accounting information is produced on a consistent basis to allow for reliability. However, financial statement preparers who may wish to alter the content of the messages being transmitted to stakeholders may deliberately distort this information through creative accounting. Although opinions differ on what creative accounting is all about, Naser (1993:2) presenting an academic view opines 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"***.**

Earnings management is another form of creative accounting and it is generally described as a purposeful intervention by management in the earnings determination process, usually to satisfy

selfish objectives. This process is clearly seen in the following definitions of earnings management by Bruns and Merchant (1990) in Akers, *et al* (2007:1)

> *"Earnings management is recognized as attempts by management to influence or manipulate reported earnings by using specific accounting methods (or changing methods), recognizing one-time non-recurring items, deferring or accelerating expense or revenue transactions, or using other methods designed to influence short-term earnings".*

However, Ningi (2006) while arguing for earnings management describes creative accounting as one aspect of earnings manipulation which does not violate accounting standards or corporate laws because of the lack of relevant standards or laws, for example, when firms engage in business innovation.

The above excerpts suggest that creative accounting is seen differently by various writers depending on the perspective from which they are evaluating the performance of an organization. It becomes worrisome particularly, when an enterprise that has been reporting high profits, suddenly experiences going concern problems and eventually goes into liquidation. There is therefore, a lot to ask about the financial numbers which had been published earlier and on which a number of investment decisions had been made. It all means that creative accounting can be used, whether or not, within the ambit of existing accounting rules to boost reported profits or minimize reported losses; help conceal financial risk; circumvent borrowing restrictions and escape shareholder control.

In this study, we examine the reasons for creative accounting practices and whether there is any relationship between creative accounting and firm financial performance reporting in Nigeria, and to what extent do these practices impact on or influence financial performance reporting, with dividend payout as proxy, of banks and insurance firms.

The empirical results of the study reveal that creative accounting practices are positively associated with firm financial performance reporting; particularly, these techniques significantly impact on Dividend Payout (proxy for profitability) though with minimal influence on liquidity needs.

This research contributes to literature in four ways. First, it provided a model for predicting the relationship between firm financial performance and creative accounting practices: Financial Performance Reporting (FPR) = *f* (APC, AT, TGT, MSFEDA, RPFN), where FPR is indicated by Profit and Liquidity while APC is Accounting Policy Choice, AT is Artificial Transactions, TGT is Timing of Genuine Transactions, MSFEDA is Management Scope for Estimation in Discretionary Areas and RPFN is Reclassification and Presentation of Financial Numbers. Profit is measured with Return on Assets (ROA) and Dividend Pay-Out serving as proxies while Current Ratio (CR) serves as proxy for Liquidity. The collapsed data for the three performance measures and five creative accounting techniques were correlated to determine the extent of relationship. It is expected that management desiring to smooth their declining profits or reduce their leverage ratios to mask their true financial performance will resort to intensive application of creative accounting techniques. This is perhaps the first attempt at developing a model for predicting relationship between creative accounting practices and reported firm financial performance of companies in the financial sub-sector of the Nigerian Economy. Second, this study advanced existing body of knowledge in the area of creative accounting beyond the conceptual and attitudinal realm. The work is perhaps, the first foremost effort to provide empirical evidence of the existing creative accounting techniques adopted in the Nigerian financial services industry and to measure both the individual/singular and combined

effects of techniques on the competing corporate objectives of profitability and liquidity in the sector. Third, this study, probably for the first time in Nigeria, isolated the most potent creative accounting practices that are used by corporate entities in massaging reported financial figures in accounts. Of the five commonly used techniques identified, Management Scope for estimation in Discretionary Areas, and Reclassification and Presentation of Financial Numbers in financial statements stood out as the most significant massaging tools for window-dressing financial figures in reported financial statements. The remainder of this paper is organized as follows. The second section reviews relevant literature, motivation for creative accounting, empirical works and development of hypotheses. The third and fourth sections describe the research method and present study findings, respectively. The final section summarizes the study and concluding remarks.

II.Theory, motivation and hypotheses

The International Financial Reporting Standards (IFRS) Framework (2001:2) for the Preparation and Presentation of Financial Statements states the purpose of financial statements as:

"…The objective of financial statement is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions".

The framework clearly specifies that the qualitative characteristics of financial statement should be understandable, relevant, reliable and comparable. It further specifies that the reported income and expenses should be directly related to an organisation's true financial performance reporting.

Thus, firm financial performance as represented by quality of profit/earnings *et cetera*, is a measure of the ability of reported profits/earnings to reflect the firm's true profit/earnings and to help predict future profit/earnings (Akers, Giacomino and Bellovary, 2007).

In financial accounting, accounting theory is not an end per se, but a means to an end. Theories reflect either descriptive or prescriptive behaviour; the way individuals or firms actually do or should act.

This body of theoretical principles provides the basis for the development of new reporting practices. For example, accounting policies consists of developing accounting standards guided by a basic theoretical framework of financial reporting. But the accounting bases which are adjudged to be the most appropriate are adopted for the purpose of preparing financial statements. These bases formed the root of accounting policies. They are used to provide fair and objective financial reporting though the user is allowed the freedom to choose the appropriate base when there are different bases. However, Macve (1981:8) in Ihendinihu (2005:7) was of the opinion that rational choice of accounting procedures cannot be made without some framework of principles.

Creative accounting is the result this freedom of choice of bases or methods in presentation of certain accounting entries. This being the case, one should not however, forget that such practices should operate within a framework or by the book. Thus, stressing this need, Ezejelue (2001:79) argues that:

"Financial Accounting should operate within a framework to encourage logical development of principles and practices. This affords some protection to various investors who reach

investment decisions by making comparisons of financial statements of various companies supposedly prepared on a reasonably consistent basis".

As a further measure to protect the investor where there are different methods, paragraph 1 of the Statement of Accounting Standard (SAS No. 1) states that:

A substantial number of alternative postulates, assumptions, principles and methods adopted by a reporting entity in the preparation of its accounts can significantly affect its results of operations, financial position and changes thereof. It is therefore essential to the understanding; interpretation and use of financial statements, whenever there are several acceptable accounting methods which may be followed, that those who prepare them disclose the main assumption on which they are based.

The provisions of Schedule 2 of Companies and Allied Matters Act (CAMA) 1990 (as amended, 2004) also requires the disclosure of the methods or basis used to deal with or calculate the amount of an item or information; where the account would be misleading by reason of failure to explain such method or basis.

The intention of the above provision in CAMA and that of the SAS earlier stated is to enable any reader of financial reports to understand and interpret such reports and information disclosed therein.

Further, the SAS 2 recognizes that accounting information about business entities is required by a range of users to meet public and other business interests and such needs dictate the fundamental objectives of accounting and mode of reporting information. The Standard enumerates the needs of various users of accounting information. It also specifies that financial statements should provide quantitative and qualitative information which will aid users in making informed economic decisions; though such presentations should be simple, clear and easy to understand by all users.

In a number of cases, the creative accountant deliberately operates outside the norms of approved standards and /or even does not disclose the method or basis adopted in dealing with a particular accounting entry. This danger of manipulation is very prevalent in systems, where the basic accounting principle is not the economic reality but the compliance with very detailed rules (Van and Bealden, 2003:3).

Creative accounting has been described in a number of ways by both experts and non-experts in accounting and finance. Amat, Blake and Dowds (1999) defined creative accounting as a process whereby accountants use their knowledge of accounting rules to manipulate the figures reported in the accounts of businesses. Griffiths (1986:1) writing from the perspective of a business journalist, described creative accounting in the following words:

Every company in the country is fiddling its profits. Every set of published account is based on books which have been gently cooked or completely roasted. The figures which are fed twice a year to the investing public have all been changed in order to protect the guilty. It is the biggest con trick since the Trojan Horse … In fact, this deception is all in perfectly good taste. It is totally legitimate. It is creative accounting.

Jameson (1988:7-8), writing from the perspective of the accountant argues that:

The accounting process consists of dealing with many matters of judgment and of resolving conflicts between competing approaches to the presentation of the results of financial events and transactions … this flexibility provides opportunities for manipulations, deceit and misrepresentation. These activities practiced by the less scrupulous elements of the accounting profession have come to be known as creative accounting.

The following points are discernible from the above definitions. First, creative accounting is mostly applied with deceitful motives and as such is an undesirable practice. Also the application of creative accounting techniques has the potential of biasing assessments of the performance of economic entities, and thus of genuine economic growth of the economy. Again, there are ethical issues; as the accounting profession remains challenged by the scale of manipulation, deceit and misrepresentation that are permitted to exist in published financial statements because of the freedom of choice legally allowed in accounting rules. The Nigerian accounting system permits the freedom of choice of accounting methods and thus is equally susceptible to manipulation by the less scrupulous members of the accounting profession who use different creative accounting techniques to fiddle, manipulate and /or misrepresent figures in financial statements.

A number of creative accounting techniques, motives for creative accounting and empirical works exist in accounting literature and a review of some major ones will help to position our discussion.

Accounting Policy Choice (APC)

Extant accounting rules allow a company to choose between different accounting methods. In many countries, for example, a company is allowed to choose between a policy of writing off Research and Development expenditure as it occurs and amortizing it over the life of the related project. A company can therefore chose the accounting policy that gives it preferred image. Another area of this flexibility is in respect of asset valuation. International Accounting Standards permit a choice between carrying non-current assets at their revalued amounts or depreciated historical cost (Amat, *et al,* 2003). Business enterprises may validly change their accounting policy to give them their preferred image. For example, Schipper (1989) in Amat *et al* (2003) observes that such changes may be relatively easy to identify in the year of change but are much less readily discernible thereafter.

Management Scope for Estimation in Discretionary Areas (MSDEDA)

Certain entries in accounts of companies involve an unavoidable degree of estimation, judgment and prediction. Amat, et al (1999:4) gave examples of estimation of an asset's useful life made in order to calculate depreciation. These estimates are normally made inside the business and the creative accountant has the opportunity to err on the side of caution or optimism in making the estimate. In other cases, an outside expert is normally employed to make estimates. In this case, the creative accountant can manipulate the valuation both by the way in which the valuer is briefed and by choosing a valuer known to take a pessimistic view as the company prefers. In an earlier study, Grover (1991b) reports the case of a film company, Orion Pictures, in which a decision has to be made on how to allocate film production costs. Initially, these are capitalized and amortized against related earnings. Orion was reported as one of the most optimistic firms, 'taking write-downs on films that did not measure up' thereby delaying charges against revenue with a view to reporting impressive picture of good financial performance.

These 'earnings management' techniques can go without running fowl to existing accounting principles. Agreeing to this view, Henry (2004) asserts that companies, even when legally abiding by the accounting rules, can massage the presentation of their earnings and cash positions. He identified the following areas as most susceptible to abuse by management freedom of judgment and estimation:

- Estimate Sales
- Predict bad Debts
- Adjust Inventory
- Forecast unusual gains or losses
- Massage cash

Artificial Transactions (AT)

Artificial transactions can validly be entered into both to manipulate balance sheet amounts and to move profits between accounting periods. A company can enter into two or more transactions with an obliging third party, normally a bank to achieve this (Amat, *et al.*, 1999). An arrangement to sell an asset to a bank and lease that asset back for the rest of its useful life could be entered into with a view to window-dressing financial figures in the account, particularly when the sale price under such a 'sale and leaseback' can be pitched above or below the value of the asset, because the differences can be compensated for by increased or reduced rentals.

Timing of Genuine Transactions (TGT)

Creative transactions can be timed to give the desired impression in the accounts. A business which has an investment of N300 million at historical cost can easily be sold for over N900 million, at the current value (that is, three times the historic cost) is at liberty to creatively choose the year in which to sell the investment and so increase the profit in the account.

Reclassification and Presentation of Financial Numbers (RPFN)

Firms may engage in creative accounting in the form of Balance Sheet manipulation where they reclassify liabilities in order to smooth reported liquidity and leverage ratios (Gramlich *et al,* 2001). Another special area of creativity is the presentation of financial numbers based on cognitive reference points. Nisakanen and Kelohorju (2000) in Amat, *et al* (2003) explain that the idea behind this behavior is that humans may perceive a profit of say, 301 million as abnormally larger than a profit of 289 million. Their study and those of Van (2003) have indicated that some minor massaging of figures does take place in financial statements in order to reach significant reference points.

Another way in which creative manipulation of financial numbers can be done in Financial Statements is by deducting items of expenditure from the balance of accumulated profits brought forward instead of the current year's Profit and Loss account. The entities Profit and Loss Account would have reflected a more reliable operational result for the year if such revenue expenditures were expensed through the Profit and Loss Account of the current year.

Motives for Creative Accounting

A number of notable studies (Grover, 1991a; Collingwood, 1991; Schroeder and Spiro, 1992; Sweeny 1994; Dahi, 1996; Fox 1997; Amat *et al*, 1999 and 2003; Gremlich, 2001; Leuz, Nanda and Wysocki, 2003; Henry, 2004; Desai and Dharmapala, 2006; Ningi, 2006; Chen, 2007) have investigated the reasons why entities seek to manipulate their accounts, and agree to the following:

1. Income smoothing, borne out of the desire to report a steady trend of growth in profit, rather than to show volatile profits with a series of dramatic rise and falls.
2. Manipulate profit to tie into forecasts, another variant of income smoothing.
3. Income boosting Accounting Policy change often made to distract attention from unwelcome news of the company's actual performance and ranking among its peers.
4. Boost/maintain share price with the effect of reducing the apparent level of borrowing and creating the appearance of a good profit trend and thus position the company at a vantage position for new share issues and takeover bids.
5. Directors Insider Dealings involving delay in release of information for the market to enhance their opportunity to benefit from their inside knowledge.
6. Circumvent contractual rights, obligations and constraints; prevalent where companies are subject to various forms of contractual rights, obligations and constraints based on the amount reported on the accounts.
7. Avoid Government Regulations by choosing accounting methods that tend to reduce their reported profits.
8. Enhance Directors Bonus Scheme where the scheme is linked to profit or the company share price.
9. Profit sharing arrangement may induce choice of accounting methods to minimize declared profit to depress claim on the company.
10. Tax saving purposes where taxable income is measured in relation to the accounting figures.
11. Change in management with a motivation to shift responsibility for losses and poor performance to previous management.

Fischer and Rosenzweig (1995) also carried out another study in the USA on the attitudes of accountants and students towards creative accounting and not on how creative accounting affect reported corporate performance. They found that accountants and students were more critical than accounting practitioners of manipulated transactions, where as accounting practitioners were more critical than students of abuse of accounting rules. They offered two possible explanations for accountants' attitude: (a) Accountants may take a rule-based approach to ethics, rather than on the impact of creative accounting on users of accounts. (b) Accountants may see abuse of accounting rules as falling within their domain, and therefore demanding their ethical judgment, while the manipulation of transactions falls within the domain of management and so is not subject to the same ethical code. This study did not consider the probable effect of creative accounting on reported corporate performance.

Amat and Blake (1996) this study was carried out in Spain about the attitudes of auditors towards creative accounting. The summary of results of the survey showed that 31% of the respondents believe that the use of creative accounting is a legitimate business tool while 38% agreed that creative accounting is a problem that can never be solved. This study is similar to that carried out in the UK, though the respondents' attitude towards creative accounting in the two

countries differed greatly. There was also no attempt to x-ray what effects creative accounting could have on reported corporate performance.

Leuz, Nanda and Wysocki (2003): This study was carried out to determine systematic differences in earnings management across 31 countries using financial accounting data from 1990-1999 for 8616 firms. The authors used/created four proxies that capture the extent to which corporate insiders use their accounting discretion to mask their firms' economic performance. They adduced empirical evidence to show that earnings management (creative accounting) is positively associated with the level of private control benefits enjoyed by insiders. The results highlight insiders' incentives to manage earnings as a way to conceal their private control benefits. The study also provided evidence that the level of outside investor protection endogenously determines the quality of financial information reported to outsiders. The positive association meant that the higher the level of private control benefits enjoyed by insiders the more intensive application of earnings management tactics to cover up such benefits from outsiders.

Ningi (2006) looked at the different perspectives of earnings management, a variant of creative accounting. He argued that earnings management is beneficial to firms' various contracting parties and investors, as well as the benefits on social resource allocation rather than being harmful. The study advanced reasons why different stakeholders benefit from earnings management practices. The study, in looking at the apparent benefits of earnings management to firms and society, fail to examine to what extent these practices had impacted on the reported performance of affected firms.

Desai and Dharmapala (2006) carried out a study to determine the relationship between earnings management and corporate tax avoidance. They advanced empirical evidence to indicate that conceptualising corporate tax avoidance within an agency perspective provides a fuller and more accurate depiction of the motivations during this phenomenon. This meant that tax shelter products enable managers to manipulate reported earnings to mask true economic performance of their companies.

Chen (2007) carried out a study in Taiwan to determine whether corporate organisations that are indicted for employing creative accounting practices reported higher earnings before and after tax (EBIT and EAIT) than those not so accused. The study involved 90 firms found guilty for materially misrepresenting their financial positions and operating results between 1999 and 2004 (5-year period) and 1035 listed companies not accused of fraudulent acts during the same period. The study revealed that the accused firms reported smaller EBIT values and smaller changes in EBIT compared to those of the control group at 5% significant level. They also reported significantly higher or greater increases in after tax net income than the control group. Three elements, incentives and pressures, opportunities and attitudes and rationalisations were confirmed to be sufficient for explaining asymmetric and longer right-tailed distributions of change in EBIT and net income (NI) as reported by earnings manipulators. Earnings manipulators had stronger incentive to surpass earnings forecasts by 125 to 625% compared to -125 to 375% for the control group.

The study however, failed to determine what creative accounting methods were employed and to what extent such practices directly influenced the reported higher increases in after tax net income.

Based on the above literature, we posit the following two hypotheses in the null form.

Ho1: There is no significant relationship between creative accounting and reported financial performance of companies in Nigeria.

Ho2: Creative Accounting does not have any significant effect on the amount of Dividend Pay-Out (DPO) of Nigerian Companies.

III. Methodology

The research design adopted in this paper is a blend of exploratory and explanatory research (cross sectional survey and ex-post facto) designs. One set of researcher designed questionnaire was administered (after establishing its validity and reliability) on a sample of 386 respondents drawn from 20 quoted banks and insurance companies in two selected sectors of the Nigerian Stock Exchange. The instrument sought to obtain opinion on various aspects of the problem being investigated

The area of study covers seven states in the South-South and South-Eastern part of Nigeria specifically, Rivers Abia, Imo, Enugu, Cross-Rivers, Anambra and Akwa-Ibom where the 20 selected quoted banks and insurance companies have operating base/regional office.

Two sets of data were collected for analysis.

- Five-year financial summary of the 20 sampled firms from 2004-2008 with which three (3) basic financial performance measures for profitability (Return on Assets- ROA and Dividend Pay-Out-DPO) and Liquidity (Current Ratio-CR) were computed.
- Survey data from a total of 386 respondents to our questionnaire. Ranked opinion on five explanatory variables derived from literature were obtained and used as proxy for creative accounting techniques. These proxies of creative accounting are: Accounting Policy choice (APC), Management Scope for Estimation in Discretionary Areas (MSFEDA), Artificial transactions (AT), Timing of Genuine Transactions (TGT), Reclassification and Presentation of Financial Numbers (RPFN).

These data were statistically analysed using correlation and regression techniques and the results obtained formed the basis for our discussion and conclusions.

The study specifies a model which attempts to determine the relationship between creative accounting and financial performance reporting. The dependent variable is financial performance reporting (FPR) which is indicated by profitability (ROA and DPO as proxies) and Liquidity (CR as proxy); while the independent variables include, APC, AT, TGT, MSFEDA and RPFN.

FPR = f (APC, AT, TGT, MSFEDA, RPFN)

The model in its econometric form is as follows:

$FPR = a_0 + b_1APC + b_2AT + b_3TGT + b_4MSFEDA + b_5RPFN + U_1$

Where a_0 is the intercept, b_1-b_5 is the partial regression coefficient of slope and U_1 is the error term.

A Priori expectation

$\beta_0 > 0, \beta_1 > 0, \beta_2 > 0, \beta_3 > 0, \beta_4 > 0, \beta_5 > 0.$

IV. Results and discussion

The results of our analysis are presented and discussed under two main subsections.

Relationship between Creative Accounting and Financial Performance Reporting.

The study sought to test the hypothesis that:

There is no significant relationship between creative accounting and reported financial performance of companies in Nigeria.

This relationship was tested using Spearman Rank Correlations Technique on the collapsed data of the three measures of performance and five identified creative accounting techniques. The result of the analysis produced a correlation coefficient (r) of .569 at 1 percent level. The coefficient indicates the existence of positive and moderate relationship between Creative Accounting and reported Financial Performance of study firms. A test of significance of r following the methodology in Olatunji and Igbokwe (2006:102) and Ezejelue, *et al* (2008:187) gave a t_{cal} of 23.96 which is greater than t_{tab} of (2.576). We therefore reject the null hypothesis and conclude that that there is significant relationship between creative accounting and reported financial performance. This finding largely explains why companies desiring to smooth, boost or even window-dress declining income figures in financial statements resort to increased application of creative accounting techniques. The more the techniques are applied, the greater the level of deception and misrepresentation of the true financial performance of the reporting entity.

Effect of Creative Accounting on reported Financial Performance of companies.

We investigated the effects of the five identified creative accounting techniques on the financial performance of Nigerian banks and insurance firms. First, we assessed the effect on each of the measures of performance: Return of Assets (ROA), Dividend Pay-Out ratio (DPO), proxies for profitability; and Current Ratio (CR) proxy for liquidity, the results of which are not discussed except the one on DPO, the object of the study. The result on DPO is shown in Table 1 below. Second, we assessed the overall effect of applying the techniques on the reported financial performance of companies using the collapsed data of the two sets of variables. This is shown in Table 2.

A measure of profitability investigated is Dividend Payout Ratio (DPO). Table 1 below shows the result of our test.

Table 1: *Effect of Creative Accounting on Dividend Pay-Out ratio*

Functional Forms	Linear	Semi-log	Double-log	Exponential
Constant	1.72***	3.007***	-1.068***	-7.852***
	(7.940)	(52.302)	(6.010)	(-8.159)
TGT	-.393***	-.130***	-1.276***	-4.466***
	(-3.543)	(-3.877)	(-12.290)	(-10.223)
MSFEDA	1.205***	.145***	1.054***	7.582***
	(16.165)	(22.125)	(52.011)	(25.824)
RPFN	-.130**	-8.47E-03*	.192***	1.707***
	(-2.459)	(-.685)	(5.030)	(8.209)
AT	-.524***	-1.09E-02*	-2.565E-02*	-2.376***
	(-6.816)	(-.331)	(.251)	(-7.849)
APC	3.554E-02*	-7.31E-03*	-3.23E-02*	.805***
	(1.386)	(-.546)	(-.780)	(-3.313)
R2	.584	.588	.880	.804
F-ratio	106.481***	107.611***	552.476***	311.180***

*Source: Computed from Survey Data, 2010 and published Annual Accounts of 20 selected quoted companies. ***, **, * = Significant at 1%, 5% and 10% respectively, t-values are in parenthesis. Key: TGT= Timing of Genuine Transactions, MSFEDA= Management Scope for Estimation in Discretionary Areas, RPFN= Reclassification and Presentation of Financial Numbers, AT= Artificial Transactions, APC= Accounting Policy Choice*

Table 1 above indicates that the double-log form yielded the best fit having produced the highest R^2 value and three significant variables. The R^2 of .880 indicates that the five creative accounting techniques can predict about 88 percent of the variations in the dividend pay-out ratio (DPO), another profitability measure. This implies that about 12 percent of the changes in DPO are attributable to other factors. Of the five explanatory variables in Table 1 MSFEDA and RPFN have positive coefficients, implying direct relationship with DPO and thus, represent the most potent creative accounting practices used in massaging reported financial figures in accounts. Usually, certain entries in the accounts of companies involve unavoidable degree of estimation, judgment and prediction. The *a priori* expectation is that companies, even when legally complying with the accounting rules, can use management discretion and abuse of judgment to massage the estimation and presentation of their earnings to achieve desired growth in earnings and dividend pay-outs. This they do in estimating sales, predicting bad debts, adjusting inventory and forecasting unusual gains or losses, all of which directly affect profitability. Reclassification and presentation of financial numbers are equally practices for reflecting a more rosy operating result. These result accords with the findings of Henry (2004), Fox (1997), Gremlich (2001), Collingwood (1991 and Amat *et al* (2003) who found income smoothing and boosting to be one of the compelling reasons for creative accounting. The econometric value of F-ratio of 552.476 is significant at 1 percent alpha level, highlighting the appropriateness of the model specification.

Table 2 below shows the overall effect of creative accounting on reported financial performance of study firms. It provides a further combined statistical basis for testing hypotheses 2 using the collapsed data of ROA, DPO and CR and the five identified creative accounting practices.

Table 4: *Regression Test Results of Creative Accounting Techniques and Reported Firm Financial Performance*

Test Statistic	Test Results
Correlation Coefficient (r)	.718
Coefficient of Determination (R^2)	.516
F-Ratio	1265.626***
β Coefficient	.656***
t	35.576

*Source: Computed from Survey Data, 2010 and published Annual Accounts of 20 selected quoted companies; *** 1% significance level*

Table 2 above shows R2 as .516. This implies that about 51.6 percent of the variations in firm financial performance (ROA, DPO and CR) are determined by changes in creative accounting techniques, with about 48.4 percent of the variations attributable to other factors. The f-ratio of 1265.626 is statistically significant at 1 percent level, attesting to the appropriateness of the model specification. The computed t-value (35.576) is also shown to be statistically significant at 1 percent alpha level, hence we conclude that the application of creative accounting techniques in preparation and presentation of financial statements have significant effect on reported financial performance of banks and insurance companies in Nigeria.

It is our *a priori* expectation that profitability and by extension, dividend pay-out are prime targets for creative accounting as increases in the application of the techniques result in the reporting of higher but deceptive profitability picture against the backdrop of the economic reality of firm performance.

V. Concluding Remarks

In this study, we explore the relationship between reported firm financial performance (FPR) indicated by profitability (ROA and DPO as proxies) and Liquidity (CR as proxy) and five identified creative accounting practices measured by TGT, MSFEDA, RPFN, AT and APC in the financial sub-sector of the Nigerian economy. The findings indicate that FPR is positively associated with creative accounting practices and that the techniques significantly impact on DPO, the object of the study.

Findings from the study have three main implications for policy action. First, is on the area and extent to which creative accounting practices could be regulated by the supervisory authorities in Nigeria. Second, is on the appropriate enforcement framework needed to exert compliance by companies in the preparation and presentation of financial statements. The third relates to ethical challenges of creative accounting. To address this policy challenges, the study makes the following recommendations.

Accounting Standard Setters/Regulators should consider reducing the range of accounting choices allowed for the same economic transaction. This would effectively reduce the opportunities of creative accounting in the area of choice of accounting methods.

Accounting regulators should reduce the area allowed for subjective evaluation. Abuse of judgment, creative presentation of financial numbers and for dishonest estimates can be curbed by drafting rules that minimize the use of judgment and specifically requiring auditors to play a key role in identifying dishonest estimates. Standard setters should also consider the abolishing of the category of 'extraordinary item' in the Profit and Loss Account. This was the case in the UK where the Accounting Standards Board (ASB), in response to UK company accountants' tendency to use the 'extraordinary item' part of the Profit and Loss Account for items they wished to avoid included in operating profit, abolished it.

The concept of 'substance over form' should be strictly interpreted/enforced to determine true and fair view of financial statements. Artificial transactions could be curbed by invoking this concept, whereby the economic substance rather than the legal form of transactions determine their accounting substance. Thus, linked transactions would be accounted for as one whole.

External auditors should be required to prepare, in addition to the normal attestation, a 'quality of earnings report' on the income statement. This will assist auditors to pay particular attention in identifying earnings management schemes by companies.

The accounting profession should strengthen its ethical code so that the individual accountant or auditor will be less willing to connive at creative accounting. This has become imperative in view of the ethical challenges to the accounting profession posed by creative accounting resulting from the enormous scope for abuse of accounting policy choice, judgment and assumptions about the future and reclassification and presentation of financial numbers in financial statements.

Finally, the need for a stronger regulatory regime with effective enforcement mechanisms for ensuring compliance with accounting and auditing standards cannot be over emphasized. This should improve quality of financial statements as misstatements of financial statements would attract prosecution of offenders. Thus, the enthronement of a more stringent regulatory regime with effective enforcement mechanism will ensure compliance with accounting and auditing standards; reduce areas of accounting policy choice and limit scope for dubious management judgment and assumptions.

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