Creative Accounting Practices and Financial Performance of Firms

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ABSTRACT
The study examined creative accounting and firm's financial performance using secondary data obtained from Nigeria Stock Exchange and tries to ascertain whether food and beverage firms in Nigeria massage income using seasonal trading reports. STR was subjected to Hausmann test for selection of appropriate model and regressed against performance variables return on assets, returns on equity and earnings per share. Test of causality was conducted to determine whether there is causal relationship amongst the variables of study. Result showed STR has no significant relationship with ROA, ROE and EPS and not used to manipulate ROA, ROE and EPS. STR has negative relationships with performance variables and we conclude that an increase in STR decreases performance.
Keywords: Creative Accounting, Seasonal Trading Reports, Return On Assets, Returns On Equity, Earnings Per Share

INTRODUCTION
Creative accounting in the context of this study is the intentional modification and window dressing of reported earnings either to achieve the motive of preparers by presenting a plausible outlook of the firm to outsiders or to achieve personal gains for Managers or achieve certain goals for the firm. It is carried out within the limits of legality without violating accounting rules. Creative Accounting is also recognised as Earnings management. Creative accounting is nothing new. It has been in existence right from the origin of accounting and to the extent that managers are given the laxity to take decisions on behalf of various stakeholders in an entity. This latitude granted Managers lead to conflicts of interests between the set goals of the organisation and that of agents (Managers). The failure to align the interest of managers with that of organisation lead to conflicts of interests and the necessity to curtail the activities of agents by instituting control mechanisms in the form of accounting standards, internal control, auditing and corporate governance. Despite these initiatives businesses continue to fail and report bankruptcies leading to continuous tightening of standards and accounting rules by regulators due to the negative impacts

business failures have on the economy in terms of growth of per capita income, declining production, unemployment and loss of investment.

There are many strategies which are used to falsify reported earnings. These include timing sales of long lived assets, deliberate postponement of expenses, bogus recognition of income or recognition of non-existent income, delay in expense or income recognition, extensive and generous provisioning of bad debts, big bet method , delay in recognition of losses and use of related party transactions to bloat income of the group.

Rich body of literature exist on creative accounting. Most of these studies were conducted in advanced countries using generally accepted Accounting principles (GAAP). Even then findings produced mixed results. Paucity of research in this area in third world economies and mixed results produced by previous studies calls for more empirical research on the subject. Secondly, the tightening of standards through the convergence of local standards to International Financial Reporting standards (IFRS) exacerbate the need for more research on the subject area. Thirdly, technological advancement imply new strategies may be adopted technologically to falsify earnings and therefore an encouragement for more research on creative accounting. Fourthly, disparity in cultural background and differences between third world economies and advanced economies limits the level of generalisation that previous studies could be applied. Also, recent studies in West African countries are carried out in banking and other sectors with probably none in food beverage and pharmaceutical firms. Industry specific characteristics may affect generalisation hence the need for further studies. Finally, there is probably no study in Nigeria that x-ray creative accounting using seasonal trading report and this study may advance the body of knowledge in Nigeria. These scenarios create gaps for further studies.

The objective of this study is to ascertain if Nigerian firms use seasonal trading reports to impact Reported earnings

2.0 LITERATURE REVIEW
2.1 Theoretical Framework
Conflict of Interest
Agency relationship occurs when owners of a business (principal) engage other individual (s) as worker (agent or steward) to execute tasks on their behalf. This relationship requires delegation of decision-making authority to the steward by the principal and the resulting division of labour are advantageous in enhancing an efficient and productive economic activity. However, such delegation also imply that the principal requires to place trust in an agent to act in the principal's best interests. Sometimes agents in the exercise of its responsibilities deviates from the goal of the principal and pursue self-interest. The extent of uncertainty about the agents desire to embark on self-interest motives rather than conform with the expectations of the contract represents an agent risk (which leads to agency cost) for an investor (Fiet, 1995). The principals will be desirous of knowing if agent actions yield profit or not.

A simplistic agency model proposes that, as a consequence of information asymmetries and self- interest, principals lack reasons to trust their agents and will seek to resolve these concerns by putting in place mechanisms to align the interests of agents with principals and thus reduce the extent of information asymmetries and opportunistic behaviour.

Agents probably will have different motives from that of the principal. They may be motivated by factors such as financial rewards, employment opportunities, and relationships with other parties that are not directly relevant to the interest of the principals. This probably result in a tendency for agents to be more optimistic about the economic performance of an entity or their performance under a contract than the reality would suggest. Agents may also be more risk averse than principals. As a result of these disparity of interests agents may have an incentive to bias information flows. Principals may resent information asymmetries where agents are in possession of superior information to which principals do not access. These conflicts of interest may produce creative accounting practices or manipulation of financial statements with the resultant effect of bankruptcy of firms. Opportunistic behaviour by agents may be aimed at fulfilling debt covenants, increasing wage compensation, smoothing income and mitigating political costs.

It is an important postulation by agency theory that accounting has a significant role in providing information; the so called stewardship function of accounting where agents report on the activities of the entity to the principal (Ijiri, 1975). According to Revsine (1991) agency theory give managers the laxity to search for existing gaps in financial reporting and to adjust accounting figures to the extent possible to meet their aims.

Legitimacy Theory
Legitimacy theory conceive that firms strive to execute activities to obey rules of environment they operate. It implies a state where entity's activities align with the external values of society. To be legitimate, firms must obey laws of society. When activities vary from expectation of environment they operate it threatens its legitimacy and generates conflicts. The theory's conception is that social contract relates firm with domain or society firm functions (Deegan & Unerman, 2006). These are expectations of society from firm activities. The firm should obey societal standards, because deviation could draw negative attention and sanctions. Rules are flexible and dynamic over specific time horizon. Thus to sustain its legitimacy, firm must adapt to these changes and also satisfy the changed expectations from the society they operate. Consequently, firms' weather additional social responsibilities costs such as employees' health, safety, and environment hazards. Additionally, society's expectations regulate firm activities through certain requirement at predetermined periods. In summary, legitimacy theory examines how firms manage relationships with diverse stakeholders essential to its existence as going concern. Dowling & Pfeffer (1975) itemized the process which firm can legitimatize its activities:

(i) Through adaptation of goals, strategies and output and modifying activities to current interpretations of legitimacy

(ii) (ii) The firm use information, to redefine social legitimacy and ensure conformity with contemporary practices, its values and output.

Legitimacy is achieved through provision of adequate information in accounts and other public disclosure forum such as firm's website. Deegan & Unerman (2006) accounting provide framework to legitimize the efforts and accomplishments of the entity. Reporting is key for information dissemination to interested parties on social responsibility activities or actions embarked upon by entity. It can support or counter negative news that is already publicly available. Managers can use Voluntary disclosures reports to influence stakeholders and show that firms operations are legitimate. This is accomplished using Voluntary disclosures of cost of social responsibility actions and environmental activities.

2.3 EMPIRICAL REVIEW
Accounting regulations allow firms to choose accounting policies in the face of alternatives. An instance is the liberty of Managers to report long lived assets at revalued amounts or based on historical cost less accumulated depreciation. Business entities can switch their accounting policies with the intent to massage reported earnings. Schipper (1989) observed that such modifications can be easily detected in the early years but more difficult years after. Management has considerable scope for exercise of discretion in making accounting policy choices. Gramlich et al. (2001) suggested that firms can indulge in reclassification of liabilities to stabilize liquidity and leverage ratios to accomplish a particular goal. This ultimately produces a 'dressed' financial report. Financial accounting figures can be dressed based on cognitive reference points. Niskanen & Keloharju (2000) and Caneghem, V (2002) indicated that figures can be modified to reach significant reference points in published reports. Naser & Pendlebury (1992) found that a large number of all categories of firms are involved in accounting manipulations. Barnea et al. (1976) discuss classificatory smoothing using extraordinary items; their results, that classificatory smoothing does take place. Dempsey et al.1993 reported that 'evidence exist that' managers showed a propensity to report extraordinary gains on the income statement and extraordinary losses on the retained earnings statement so as to present a positive outlook of the firm in the financial report'. Moreover, this research found that the propensity to report this way was significantly greater in non-owner managed firms. Dascher & Malcom (1970) analyzed data over several years for 52 firms in the chemical industries sector relating to four income smoothing variables using ' pension's costs, dividends from unconsolidated subsidiaries, extraordinary charges and credit and research and development costs'. The findings

confirmed the hypothesis that intentional smoothing of income has occurred to show stakeholders that the earning of the firm is stable. Significant provisioning of uncertain future losses is dependent on the judgments made by managers. Healy & Wahlen (1999) cited several studies that found 'compelling evidence' of income smoothing via accruals in banks and insurers, for example, Beatty et al. (1995). Merchant (1990) examined management manipulation of accounting information *within* two firms (i.e. information used in internal reporting by divisions drawing upon both interview and questionnaire data. The research found that 'managers acknowledged manipulative behaviours and short-term orientations' Amat et al (2003) report about a study that identified creative accounting practices in Spain which ultimately affects the financial reports presented. These in all evidence creative accounting practices.

3.0 RESEARCH METHODOLOGY
3.1 Research Design
The study uses ex-post facto design because it relies on past data derived from financial statements of food , beverage and pharmaceutical firms listed on the Nigeria stock Exchange, Only firms with complete information as listed in the fact book and firm's website are included as sample.
3.2 Sample and Population
The population includes all manufacturing firms in Nigeria. The population uses census method of sampling which does not require sample size determination. However all firms in the food and beverage subsector were considered but only 35% of firms in the sector had complete data for the period 2006 to 2014 and these sample size was used for the study.
3.3 Variable
Seasonal trading report is measured as Change in sales Volume (Turnover) for firm i in period t-1 and this represents the independent variable while Return on Assets , Return on Equity and Earnings per share represents dependent variable,
3.4 Test and selection of models
This research uses panel data which combines time series and cross sectional data obtained from individual data observed repeatedly at different times. Two residual model panelling method used by Generalized Least square (GLS) to select appropriate model for testing are Fixed Effect Model (FEM) and Random Effect Model (REM).
a) Hausmann Test
H-Test is used for selecting fixed effects or random effects in data analysis. The specification is that Ho represents REM which is null form while H1 represents FEM the alternate. Carrying out Haussman test follows a statistical distribution chi square with degree of freedom as many as k. k is number of independent variables. If there is rejection of Ho where value of statistics is greater than critical value (value of table chi square) use model fixed effect, otherwise reject H1 (FEM) and accept null hypothesis Ho, Random effect model (REM)

Random Effect Model
Random effect model estimates data panel when interconnection of variable disorder between time and between individuals occur. RM is embedded in understanding that variable disorder consist of dual components which are first variable disorder that is combining time series and cross section and second variable disorder individually. It assumes unobserved effect have no correlation with independent variables. If on FEM, difference between individuals or time is reflected through intercept, then RM can be accommodated by error. Individual components of the error is not correlated with each other and no autocorrelation in data series both cross-unit and time.
Fixed Effects Model
FE model explores relation of predictor and outcome variables within entity. Each entity has peculiar traits that may or may not influence predictor variables. The model assumes that something within the individual may impact or bias the predictor or outcome variables and this should be controlled. It further assumes linkage between entity's error term and predictor variables. FE removes effect of time-invariant

attributes and examines effect of predictors on outcome variable. FE assumes time-invariant traits are unique to individual and should not be correlated with other individual traits. Each entity is peculiar therefore entity's error term and the constant which identifies individual attributes should not be associated with others. If error terms are linked, FE is not useful and lead to incorrect inferences

b) Classic Assumption Test

A classic assumption test is done to ascertain whether Generalized Least Squares (GLS) technique is appropriate. Therefore test of autocorrelation, multi-collinearity, heterokedastisitas and normality is unnecessary on panel data which uses GLS method. These are advantages panel data have with GLS methods. Data panel combines time series and cross section data and this provides more data which produces greater flexibility. This combination enables it to overcome problems arising from removing variables (omitted-variable). It is beneficial in calculating heterogeneity in individuals explicitly by allowing a variable specific individual. It controls heterogeneity and empower panel data to test models of complex behaviour. Panel data is beneficial in a study of dynamic adjustments as it facilitates repetition of cross sectional data over time. These advantages obliterate the necessity of classic assumption test and test of normality where the number is more than 30 as normal distribution is assumed.

c) Causality Test

Granger's causality test is useful in determining whether time series is beneficial in forecasting another or not. Test is done to ascertain if cause- effect relationship occur between variables. Let us assume two time series' X', 'Y'. A time series '*X'* is regarded as being caused by '*Y'* if it demonstrated normally via series of t-tests and F-tests on lagged values of '*X'* lagged values of '*Y' inclusive*), that those '*X'* values give significant statistics information on future values of '*Y'*.

The Granger test observe two basic principles:

1. The cause took effect prior to the test
2. The cause posses' peculiar information about the future values of its effect.

The time series can be stationary or non-stationary. The stationary time series process utilizes two or more level of values. In contrast, a non-stationary time series process uses first or higher values. Number of lags used in series is selected based on specific criteria like Akaike information criterion or Schwarz information criterion. Any specific lagged value of variables is used in regression provided it is significant when subjected to a t-test and also when retained variable and other lagged values of variable together increase explanatory power of the model when subjected to F-test. The null hypothesis which states 'no Granger causality' is not rejected when no lagged values of an explanatory variable have been retained in the regression.

Given the two assumptions about causality, Granger proposed to test the following hypothesis for identification of causal effect of X and Y

$$p\{\ Y\ (t+1)\ \in A\ |\ I(t)\ \neq\ p\{\ Y\ (t+1)\ \in A\ |\ 1-x\ (t)\ \}$$

Where:

P = probability, A= arbitrary non empty set and I(t) and 1-x(t) respectively denote the information available as of time t in the entire universe, and that in the modified universe where X is excluded. If the above hypothesis is exclude we say that 'X' Granger cause 'Y'

3.5 Model Specification

The functional relationship between the dependent and independent variable, the disturbance, co-efficient and intercepts for accounting manipulations and financial performance for the purpose of the research is as stated below:

FP =   f(STREPS)
Fp =   ROA, ROE and EPS
ROA   =   f (STREPS)   (i)
ROE   =   f (STREPS)   (ii)
EPS   =   f (STREPS)   (iii)

From the above functional relationship, the econometric models are specified thus

$$\text{ROA} = \alpha_0 + \alpha_1 \text{ STREPS} + U_1, t \quad - \quad (iv)$$
$$\text{OE} = \beta_0 + \beta_1 \text{STREPS} + U_2, t \quad - \quad (v)$$
$$\text{EPS} = w_0 + w_1 \text{STREPS} + U_3, t \quad - \quad (vi)$$

Using equations iv to vi above, the mathematical form of the models are specified as:

$$\text{ROA} = \alpha_0 + \alpha_1 \text{ STREPS} \quad - \quad (vii)$$
$$\hat{\text{ROE}} = \beta_0 + \hat{\beta_1}\hat{\text{STREPS}} \quad \hat{} \quad - \quad (viii)$$
$$\hat{\text{EPS}} = w_0 + w_1 \hat{\text{STREPS}} \quad - \quad (ix)$$

Where ROA is Return on Assets, ROE is Return on Equity and EPS is Earnings per share. On the other hand, STREPS is seasonal Trading reports while:

$$\text{Ui}, t = \text{Error term}$$

$$\alpha_0, \beta_0, w_o, = \text{intercepts}$$

$$\alpha_1, \beta_1, w_1 = \text{slope coefficients}$$

From equations, vi to viii, it is expected that α_0, β_1 and $w_1 > 0$. It is also expected that an increase in seasonal trading reports increases return on asset, Return on equity and earnings per share respectively.

4.0 RESULTS

HO$_1$: **Seasonal trading report does not significantly affect Return on Assets.**

Table 1: The Relationship between STR and ROA; Random Effect Model
Dependent Variable: ROA
Method: Panel EGLS (Cross-section random effects)
Date: 08/18/16   Time: 01:28
Sample: 2006 2014
Periods included: 9
Cross-sections included: 8
Total panel (balanced) observations: 72
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.174803	0.358537	-0.487544	0.6274
STR	-0.105263	1.524046	-0.069068	0.9451

Effects Specification		S.D.	Rho
Cross-section random		0.269368	0.0105
Idiosyncratic random		2.609975	0.9895

Weighted Statistics			
R-squared	0.000068	Mean dependent var	-0.177386
Adjusted R-squared	-0.014217	S.D. dependent var	2.598175
S.E. of regression	2.616579	Sum squared resid	479.2540
F-statistic	0.004746	Durbin-Watson stat	2.212378
Prob(F-statistic)	0.945270		

Unweighted Statistics

R-squared	0.000001	Mean dependent var	-0.185694
Sum squared resid	483.9629	Durbin-Watson stat	2.190852

From the Hausman test result (see appendix) the p-value is 0.2445; since this is greater than 0.05 significance level we accept the hypothesis that random effect model is more suitable than fixed effect model in assessing the impact of Seasonal Trading Report (STR) on Return on Assets (ROA). Random effect model is used to test the hypothesis which states that Seasonal Trading Reports (STR) do not significantly affect return on Assets (ROA).

Using the random effect estimation outcome in table 1, the regression of ROA on STR indicates an intercept of -0.174803, which denote that the average level of ROA is -0.174803, when STR is zero. A negative relationship exists between STR and ROA in terms of slope with a coefficient of -0.11, and p-value of 0.9451 which is far greater than the 0.05 level of significance. Based on the P-value, we accept the hypothesis which states seasonal trading reports do not significantly affect return on assets.

The negative coefficient means that every unit increase in seasonal trading report decreases the average level of return on assets by -0.11. The coefficient of determination is less than 1 percent which reveals that seasonal trading report explains less than 0.01 percent of the variation in return on assets.

HO$_2$:   Seasonal trading report does not significantly affect Return on Equity.
Table 2: The Relationship between STR and ROE; Fixed Effects Model

Dependent Variable: ROE
Method: Panel Least Squares
Date: 08/22/16   Time: 23:40
Sample: 2006 2014
Periods included: 9
Cross-sections included: 8
Total panel (balanced) observations: 72

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.586674	0.287106	2.043410	0.0452
STR	-1.071215	1.322748	-0.809841	0.4211

Effects Specification				

Cross-section fixed (dummy variables)

R-squared	0.121550	Mean dependent var	0.475833
Adjusted R-squared	0.010001	S.D. dependent var	2.152325
S.E. of regression	2.141536	Akaike info criterion	4.477392
Sum squared resid	288.9290	Schwarz criterion	4.761975
Log likelihood	-152.1861	Hannan-Quinn criter.	4.590685
F-statistic	1.089654	Durbin-Watson stat	1.360232
Prob(F-statistic)	0.382187		

Based on the Hausman test output (see appendix) the p-value is 0.05; this is just as 0.05 significance level and we reject the hypothesis that random effect model is more suitable than fixed effect model in assessing the impact of Seasonal Trading Report (STR) on Return on Equity (ROE).

We use fixed effect model to test the hypothesis which states that Seasonal Trading Report do not significantly affect return on equity (ROE).

The Fixed effect estimation output in table 2 based on the regression of ROE on STR showed an intercept of 0.586674, which denote that the average level of Earnings per Share is 0. 586674 when related parties' transaction is zero. A negative relationship exist between STR and ROE in terms of slope with a coefficient of -1.071215 and p-value of 0.4211 which is far greater than 0.05 level of significance. Based on the p-value, we accept the hypothesis which states that seasonal trading reports do not significantly affect returns on equity

The negative coefficient means that for every unit rise in STR the average level of earnings per share declines by 1.07. The coefficient of determination is 12.16 percent which indicates that seasonal trading reports only explain 12.16 percent of the variation in return on equity.

HO₃: Seasonal trading does not significantly affect Earnings per share.

Table 3: The relationship between STR and EPS; Random Effects Model

Dependent Variable: EPS
Method: Panel EGLS (Cross-section random effects)
Date: 08/18/16   Time: 01:59
Sample: 2006 2014
Periods included: 9
Cross-sections included: 8
Total panel (balanced) observations: 72
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.714638	2.073117	1.791813	0.0775
STR	-0.040801	2.058600	-0.019820	0.9842

Effects Specification				
			S.D.	Rho
Cross-section random			5.725334	0.7460
Idiosyncratic random			3.340788	0.2540

Weighted Statistics			
R-squared	0.000006	Mean dependent var	0.708412
Adjusted R-squared	-0.014280	S.D. dependent var	3.347829
S.E. of regression	3.371648	Sum squared resid	795.7609
F-statistic	0.000386	Durbin-Watson stat	0.713819
Prob(F-statistic)	0.984388		

Unweighted Statistics			
R-squared	-0.000374	Mean dependent var	3.710417
Sum squared resid	3240.953	Durbin-Watson stat	0.175266

The Hausman test output (see appendix) gives a p-value of 0.1294 which is greater than 0.05 significance level as a result we accept the hypothesis that random effect model is more appropriate than fixed effect model in assessing the impact of Seasonal Trading Report (STR) on Earnings per Share (EPS). The result of Hausmann test gives us the impetus to use REM to test the hypothesis which states that Seasonal Trading Report (STR) do not significantly affect Earnings Per Share (EPS).

Based on random effect estimation output in table 3, the regression of EPS on STR showed an intercept of 3.714638, which denote that the average level of EPS is 3.714638, when STR is zero. The table also shows a negative relationship between STR and EPS in terms of its slope with a coefficient of -0.04 and p-value of 0.98 which is far greater than the 0.05 level of significance. From this result and based on the p-value, we accept the null hypothesis that seasonal trading report do not significantly affect Earnings per Share.

The negative coefficient implies that a unit increase in seasonal trading report decreases the average level of Earnings per Share by 0.04. The coefficient of determination is far less than 1 percent with the implication that seasonal trading report contributes less than 0.1 percent of the variation in return on assets.

5.0 DISCUSSION OF FINDINGS

Managers may falsify sales or turnover figures to upswing performance and outperform competitors to create a positive signal or outlook that the firm is better than other firms or a downward swing with negative outlook to present a worse image of the firm. This is essentially such that a worse image currently will result in higher bonuses in future when performance improves. It could also imply that a worse image and reported losses is to avoid tax. The big bet method can also be deployed to boost the financial report of firms.

The result of this study indicate an insignificant relationship between seasonal trading reports and financial performance of firms in Nigeria. This insignificant relationship can be interpreted that STR is not used to massage earnings by firms in Nigeria and that firms do not use turnover to falsify financial performance. It is probable that internal controls and auditing processes implemented are effective in detecting anomalies and therefore a deterrent in the use of the method by firms.

Securities and exchange commission (SEC) require that all quoted firms in Nigeria must publish audited financial statements on quarterly basis, this increases the possibility of detection of falsified trading reports and serve as a disincentive to falsify trading reports. The Nigerian stock exchange impose sanctions on that firms that present falsified trading and shares of defaulting firms are trading on the floor of the exchange. It is possible that firms being aware of the sanctions carefully avoid being penalized.

Secondly, it can also be viewed from the perspective that good corporate governance mechanisms instituted by regulators and firms in the sector help to ameliorate these risks. The audit committee a corporate governance initiative provides oversight functions on published financial results.

6.0 CONCLUSION

The findings of the study are summarized as follows:
1) STR do not significantly influence Return on Assets, Return on Equity and Earnings per share.
2) A negative relationship exist when STR is regressed on Return on Assets, Return on equity and Earnings per share.
3) An increase in STR decreases Return on assets, Returns on equity and Earnings per share
   we found a negative relation exist between STR and ROA, ROE and EPS. This finding show that a decrease in STR increase firm performance and vice versa. . The study further revealed no significant relationship exist between STR and ROA, ROE and EPS. The implication is that Nigeria firms do not use STR to bloat earnings.

Our conclusion is that firm legitimately .legitimacy seek to align with the expectation of the society in accordance to legitimacy theory.

7.0 RECOMMENDATION

Investor protection laws, corporate governance structures and even quality of law enforcement by regulators such as SEC should be monitored by a special body set up by government

In Summary, weak enforcement of accounting standards permit firms to deviate from effective application of standards. Enforcement of investor protection laws and disclosure requirements play an important role and is a determinant of corporate ownership patterns, corporate governance and disclosure

quality. Weak investor protection laws or poor enforcement of the laws discourages dispersed share ownership and dampens external funding and cross border investments. These anomalies should be tackled by the government.

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