CREATIVE ACCOUNTING AND FINANCIAL PERFORMANCE OF MANUFACTURING COMPANIES IN RIVERS STATE

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ABSTRACT

This study examined the effect of creative accounting on financial performance of manufacturing firms in Rivers State. The study was guided by four specific objectives, four research questions and four hypotheses. Income smoothing and aggressive earnings management were used as the dimensions of creative accounting while return on asset and earnings per share were used as the measures of financial performance. The study adopted survey research design. The study made use of primary data while structured questionnaire was the research instrument used in the collection of the data. The study made use of simple random sampling to select the respondents. The respondents consisted of 121 managerial and non-managerial staff of the four selected manufacturing firms in Rivers Stale. The study made use of frequencies, simple percentages and mean scores to analyze the personal data of the respondents and other items in the questionnaire while Spearman Rank Correlation coefficient was used to test the hypotheses formulated at 5% level of significance. The data analysis was facilitated by Statistical Package for Social Sciences (SPSS) version 21. The findings of the study showed that: The study found that there is strong positive and significant relationship between income smoothing and return on asset of manufacturing firms in Rivers State. Also, there is strong positive and significant relationship between income smoothing and earnings per share of manufacturing firms in Rivers State. Additionally, a strong positive and significant relationship exists between aggressive earnings management and return on asset of manufacturing firms in Rivers State. Lastly, the study found that there is a strong positive and significant relationship between aggressive earnings management and earnings per share of manufacturing firms in Rivers State. The study concluded that financial performance of manufacturing firms in Rivers State is optimized and improved as a result of creative accounting, The study recommended that there is the need to restore integrity and public confidence to accounting operations, the accountants should be strengthened to respond quickly to the egregious abuses and malpractice in the world of business and impose sanctions on offenders.

Keywords: *Aggressive Earnings Management, Creative Accounting, Earnings per Share, Financial Performance, Income Smoothing.*

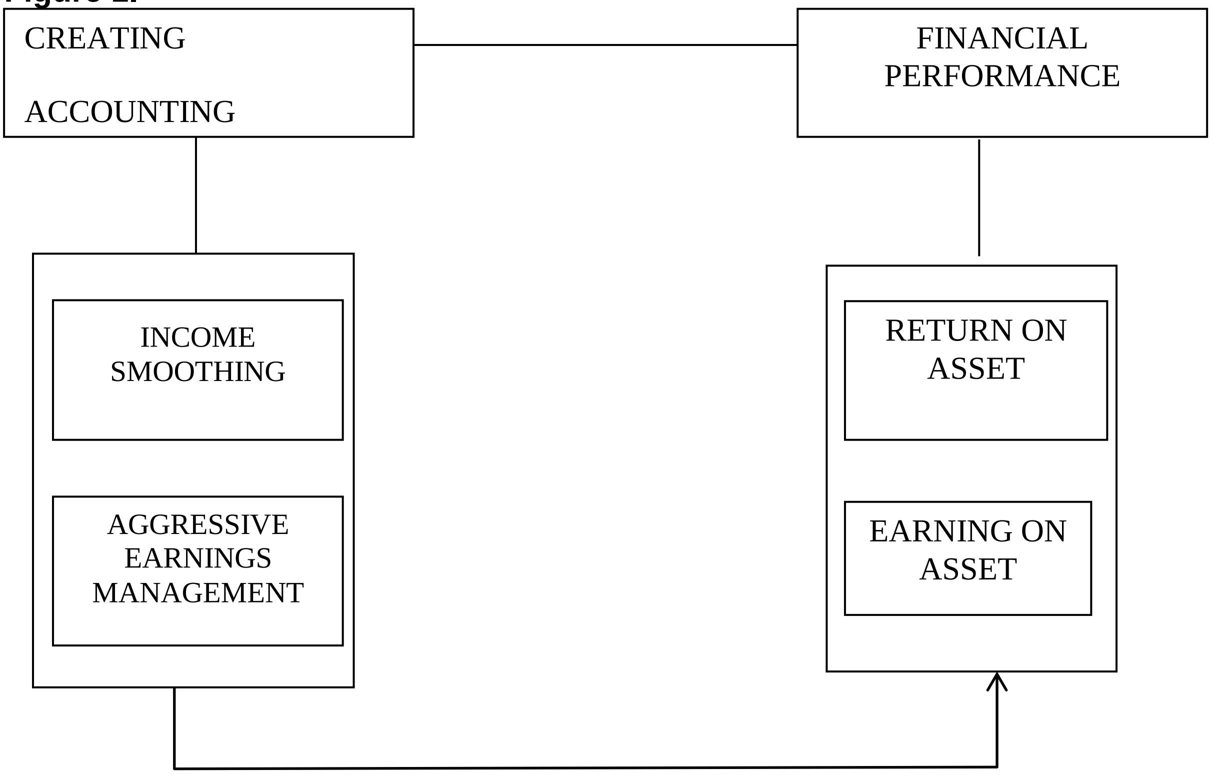
INTRODUCTION

Financial statements are the mirror of every company's business. They also represent a medium through which information on the financial position and business successes of a company are communicated, primarily to external interest groups, which makes different decisions based on such information. In order to be able to make the right decisions, the information contained in financial statements must be accurate and reliable. However, companies nowadays are increasingly resorting to "cooking" financial statements in order to present a more attractive business image and attract as many investors as possible. This is precisely why the concept of creative accounting has appeared (Branka, Ivo and Ivana, 2017). In other words, there is a distortion of financial information and presumptions of accuracy and reliability are brought into question. Increasing competition and the economic environment are just some of the reasons why companies resort to various accounting manipulation techniques, with the aim of concealing possible losses and presenting the business in the best possible light. This does not necessarily mean that there is violation of accounting standards and legal regulations, but the so-called "loopholes"' in laws are used to present a better image of the business. It should be noted that the practice of creative accounting is not illegal - which is why auditors often neglect it, but these are unethical procedures (Branka, Ivo and Ivana, 2017).

Although the creative accounting concepts became popular just two decades ago, there has always been a desire to manipulate the numbers among financial business people. Manipulating numbers to get a favourable accounting impression has a long history. Creative accounting is also known as “Earning management" and could be referred to in accounting practices as the acts that follows the letter of rules of standard accounting practices but certainly deviate from the spirit of those rules. Creative accounting practices are different from fraudulent accounting practices and thus are not illegal but immoral in terms of misguiding investors. The practices, which are followed in manipulating the books, are duly authorized by accounting system and thus cannot be considered as violation of any rule or regulations. It is characterized by excessive compliance and the use of novel ways of characterizing income, assets, or liabilities and the intent to influence readers towards the interpretations of desired results (Haruna and Emmanuel, 2017). Creative involves the use of accounting knowledge to influence the reported figures, while remaining within the jurisdiction of accounting rules and laws so that instead of showing the actual performance or position of the company, they reflect what the management wants to tell stakeholders (Osemene, Muritala and Olawale, 2014). On the other hand, financial performance is the single most important factor in assessing growth potential, earnings capacity and overall financial strength. Financial performance can be measured using three indicators namely; internal based performance measures such as Return on Assets (ROA), Return on Equity (ROE), and Return on Investments (ROI), market-based performance measures such as Tobin's Q model computed as Price/Equity's Book Value, sales and market share and lastly, shareholders return measures in terms of total shareholder return or economic value added (Richardson, 2012). In other words, financial performance of a firm can be presented in three ways namely: as a measure of the market which reflects stakeholder’s level of satisfaction in the market, as an accounting measure reflecting business efficiency level and as surveys depicting estimated financial performance (Javed, Younas and Imran, 2014). However, Ijeoma (2014) revealed that the major reason for creative accounting practices in the Nigerian firms is to inflate the operating costs to reduce exposure to taxes. It was further revealed that other key reasons for creative accounting practice among firms in Nigeria include: to help maintain or boost the share price by reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend, to inflate the amount of operating costs in order to reduce exposure to taxes, to report a steady trend of growth in profit, rather than slow volatile profits with a series of dramatic rises and falls, and to effect changes in accounting policies in order to discourage findings faults in the company's accounting system. Brank, Ivo and Ivana (2017) asserted that creative accounting can have a positive impact on a company's business in the short term, but in the long run, it may result in decreased stock prices, insolvency, and even bankruptcy. It is the root of numerous accounting scandals, as well as many accounting reforms, which is why doubts in the transparency and honesty of financial reporting arise. In addition, Ezeani, Ogbonna, Ezemoyih and Okonye (2012) found that accountants/auditors indulge in creative accounting through profit eroding mechanisms to attract investors and resources in order to boost their financial performance. Overall, the aim of creative accounting practices is usually to suit the purpose of the preparers of financial statements, who attempt to create a view of reality that they wish to communicate to users. By so doing, they undermine the quality and fundamental attributes of such financial statements, which ideally should be reliable, relevant, objective and comparable at all times (Nangih, 2017).

The main objective of this study is to investigate the effect of creative accounting on financial performance of manufacturing firms in Rivers State.

Figure 1.



Source: Conceptualized by the Researcher (2024) with Dimensions Adopted from Nanjih (2017) and Measures from Umobeng and Irenkwe (2017).

H_{01}: *There is no significant relationship between income smoothing and return on asset of manufacturing firms in Rivers State.*

H_{02}: *There is no significant relationship between income smoothing and earnings per share of manufacturing firms in Rivers State.*

H_{03}: *There is no significant relationship between aggressive earnings management and return on asset of manufacturing firms in Rivers State.*

H_{04}: *There is no significant relationship between aggressive earnings* *management and earnings per share of manufacturing firms in Rivers State.*

LITERATURE REVIEW

Osemene, Muritala and Olawale (2014) empirically examined the impact of creative accounting on firm performance in Nigeria using econometric analysis method on annual data of seven financial institutions over the period of 2006-2011. The results from Levin, Chin Chun unit root test showed that all the variables were non-stationary at level. The results from the panel least square showed that non-performing loan is positively related to return on equity and dividend pay-out while gearing ratio and net income before tax is negatively related to both return on equity and dividend pay-out. The study recommended that the need for a stronger regulatory regime with effective enforcement mechanisms for ensuring compliance with accounting and auditing standards cannot be over emphasized. Ahmed (2017) aimed to shed light on the impact of creative accounting ethics techniques on the reliability of financial reporting from auditors and academics point of view. The data was collected through a well-structured questionnaire designed and distributed to a randomly chosen sample of certified auditors and accounting instructors in some universities. Descriptive and inferential statistics were used to generalize the results and conclude on the findings. The result deduced that creative accounting techniques used by management negatively affect the reliability of financial reporting. The statutory auditor plays an important role in promoting creative accounting practice in a way that positively affects the reliability of financial reporting. Adetoso and Ajiga (2017) examined creative accounting practices among Nigeria listed commercial banks: curtailing effects of IFRS. Specifically, it examined the effect of IFRS recognition, IFRS measurement and IFRS disclosure requirements on creative accounting practices. The population of the study comprised of all the fifteen (15) listed commercial banks as at July, 2016, located in Akure, Ondo State. Simple random sampling technique was adopted to select the sample size of ten (10) listed commercial banks, out of the fifteen (15) listed in Nigeria Stock Exchange (NSE). The study made use of primary data obtained through questionnaire administered. The said primary data was analysed using quantitative approach through Statistical Package for Social Science (SPSS) Version 21 software. The formulated hypotheses were tested using Multiple Regression Model method. Result showed that in (Ho) P-value (0.000) <a (38.342) and F-value (38.342) > the critical value F* (2.829), hence, the hypothesis was rejected. Additionally, it was observed from hypothesis two (Ho), that the P-value (0.004) <a (32.871) and F-value (32.871) > the critical value F* (2.829). This means that the hypothesis was also rejected. In respect of hypothesis three (Ho,), the P-value (0.001) < a (42.717) and F-value (42.717) > value F* (2.829) .This is an indication that the hypotheses cannot be accepted. The study, therefore, concludes that compliance with IFRS recognition, measurement and disclosure requirements each has significant effects on curtailing creative accounting (manipulation of assets and equity values, income and expenses figures and non-timely recognition of losses) practices among Nigeria listed commercial banks. Ezeani, Ogbonna, Ezemoyih and Okonye (2012) examined the effect of creative accounting on the job performance of accountants/auditors in reporting financial statement in Nigeria. The study aimed at identifying the strategies used by the accountants to avoid creative accounting in any of their financial dealings. The study employed empirical survey. Two hundred and twenty seven out of 500 respondents were chosen, using simple ransom sampling techniques and Yaro Yamen's formula.

The same number of questionnaire were returned representing 100% response rate. The reliability of the instrument yielded a reliability coefficient of 0.98 indicating that the instrument is highly reliable. The data generated were analyzed using simple percentage method and pie chart for the research question, and t - test statistics for the hypotheses formulated. Among the findings made in the study was that the accountants/auditors indulge in creative accounting through profit eroding mechanisms to attract investors and resources but deceptive or fraudulent accounting practices often conduct to drastic consequences. One of the implications of the findings is that the managers of non- profits organizations may have incentives to manipulate their reported programme-spending ratios because donors use them in determining contribution decision.

Nangih (2017) examined empirically the influence of creative accounting practices on the quality of financial statements of oil servicing companies in Nigeria. To achieve the objective of the study, three hypotheses were formulated and stated thus: There is no significant relationship between aggressive earnings management and relevance/verification of financial statements, there is no significant relationship between unjustified changes in accounting policies and estimates and comparability/understandability of financial statements, and there is no significant relationship between profit smoothing and objectivity/faithful representation of financial statements. Survey research design was adopted for the study. Data were collected through well-structured and validated questionnaire and analysed done using ordinary least squares regression technique. Results of the findings revealed that creative accounting practices by oil servicing companies influenced the quality of their financial statements negatively.

Akabom (2017) examined creative accounting and earnings management, Professional and ethical issues in creative accounting, and their effects on modern financial reporting. In the light of these, the study defines Creative Accounting, listed the types of Creative Accounting methods, highlighted the impacts of creative accounting on financial reporting and provided some examples of how accounts can be fiddled. The study reiterated the fact that Accountancy profession and practice are faced with the challenges of living up to expectation with the rapid advances in technology and business methods, and often times, the Accounting standards lag behind such growths and development. Vincent, Florence and Christopher (2016) empirically investigated the influence of creative accounting practices on the financial performance of public limited companies listed in the Nairobi securities exchange in Kenya. This study considered tax avoidance, accelerated depreciation, and income smoothing as part of the major creative accounting practices that influence financial performance of public limited firms listed in the Nairobi securities exchange in Kenya. The research used both descriptive and inferential statistics to examine the major practices of creative accounting that influence financial performance of public companies listed in the Nairobi securities exchange in Kenya. The target population of this study was top management of public limited companies that is the CEO, directors, top managers and accountants. A sample of 30 public companies was drawn using purposive sampling. Logistic linear regression technique was used to analyze the relationship between creative accounting practices and financial performance and the correlation between the variables and financial performance. Qualitative approach through the use of questionnaires was adopted to help in the collection of primary data for analysis purposes. The secondary data was collected from NSE handbook, relevant textbooks, finance journals, financial statements and the website of public limited companies that were be sampled. Statistical Package for Social Sciences Software (SPSS) was used in carrying out the multiple regressions to establish the relationship between creative accounting practices and financial performance and the correlation between the variables and financial performance. Financial performance was measured using earning after tax. The study found that a strong relationship exists between creative accounting practices and financial performance. Umobong and Ironkwe (2017) 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). 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. The study concluded that an increase in STR decreases performance. Iẹoma (2014) examined the effect of creative accounting on the Nigerian banking industry with the purpose of determining the motive behind the practice of creative accounting in the Nigerian banking industry, to ascertain whether creative accounting has contributed to banks' distress in Nigeria, and to examine measures that could curb the practice in the Nigerian banking industry. Primary source of data collection was employed in this study and statistical tools used to analyze the data were the Kruskal-Wallis test and the multiple bar chart analysis. The result of this study revealed that the major reason for creative accounting practices in the Nigerian banking industry was to inflate the operating costs to reduce exposure to taxes. It was further found that other key reasons for creative accounting practice in the Nigerian banking industry include: to help maintain or boost the share price by reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend, to inflate the amount of operating costs in order to reduce exposure to taxes, to report a steady trend of growth in profit, rather than slow volatile profits with a series of dramatic rises and falls, and to effect changes in accounting policies in order to discourage findings faults in the company's accounting system. Osazevbaru (2012) sought to find out if creative accounting practice obtains in Nigeria and if such practice enhances firm's value. Primary data were collected by means of questionnaires and a chi-square test was applied to test the stated hypothesis. It was found that the practice obtains in Nigeria and positively affects firm's value which can impact on its share price. Suggestions were offered on how the practice could be reduced.

Akenbor and Ibanichuka (2012) investigated creative accounting practices in the Nigerian banking industry. To achieve the purpose of this study, research questions were raised, hypotheses were formulated, and a review of related literature was made. The population of this study consisted of 25 managers and 25 accountants drawn from the twenty-five (25) recapitalized banks currently operating in the Federal Capital Territory (FCT), Abuja. In order to collect the necessary data for this study, the survey method of research design was adopted and the primary method of data collection was employed. The major instrument used for generating the primary data was the questionnaire, which was designed in five-response option of Likert Scale. The data generated for this study was analysed through mean scores while the stated hypotheses were statistically tested with Z-test. The findings revealed that; the major reason for creative accounting practices in Nigerian banks is to boost the market value of shares: users of accounting information are adversely affected by the practice of creative accounting; accounting principles and rules should be streamlined to reduce diversities of professional judgment in financial reporting.

METHODOLOGY

The study adopted the survey research design. According to Nwankwo (2013) survey design enables the researcher to collect data from a large sample drawn from a given population and describing their elicited features based on the study carried out. the design used for the study was considered suitable for the study because they facilitate the collection of primary data systemically from a sampled population and analyze the collected data to determine the relationship between variables. The population of the study consists of all the manufacturing firms in Rivers State. However, since not all the manufacturing firms in Rivers State can be covered within the short period of carrying out this work, the accessible population of interest in this study consists of four (4) selected manufacturing firms in Rivers State with one hundred and seventy four (174) managerial and non-managerial staff.

The study employs Spearman rank-order correlation analysis to investigate the relationship between creative accounting practices and the financial performance of manufacturing firms in Rivers State. This non-parametric statistical tool was also particularly appropriate due to its ability to handle ordinal data and its robustness to outliers, which are common in financial datasets (Laerd Statistics, 2015). In the study, the simple percentages, frequencies, tables, mean scores and Spearman Rank Order Correlation coefficient was adopted as the method of analyzing the data. The simple percentages, frequencies, tables and mean scores was used for the analysis of question items contained in the questionnaire, while the Spearman Rank Order Correlation coefficient technique was employed for the test of the hypotheses of the study at 95% level of confidence (0.05 significance level). The purpose of Spearman Rank Order Correlation Coefficient method was to test the degree of relationship between the independent and dependable variables. Statistical Package for Social Sciences (SPSS) version 21 was used to analyze the data collected.

RESULTS

Decision Rule

Reject the null hypothesis (H_0) at 5 percent level of significance if the significant value (P-value) is less than 0.05.

Accept the null hypothesis (H_0) at 5 percent level of significance if the significant value (P-value) is greater than 0.05.

H_{01}: *There is no significant relationship between income smoothing and return on asset of manufacturing firms in Rivers State.*

Table 1.

Spearman's Rank Order Correlation of Income Smoothing and Return on Asset

	INCOME SMOOTHING	RETURN ON ASSET

		Correlation Coefficient	1.000	735
	INCOME SMOOTHING	Sig. (2-tailed)		.000
	N		110	110
Spearmans rank		Correlation coefficent	.735	1.000
	RETURN ON ASSET	Sig. (2-tailed)	.000	
	N		110	110

Correlation is significant at the 0.05 level (2-tailed).
Source: Researcher's Field Survey, 2024 (SPSS 21 Output)

The Spearman's Rank Order Correlation Coefficient (r) result of 0.735 shows that there is a strong positive relationship between income Smoothing and return on asset of manufacturing firms in Rivers State. Also, the null hypothesis one (**H_{01}**) was rejected since the significant value (P-value) of 0.000 is less than 0.05. The conclusion is that there is a significant relationship between income smoothing and return on asset of manufacturing firms in Rivers State. This means that there is sufficient statistical evidence to conclude that income smoothing has significant positive effect on return on asset of manufacturing firms in Rivers State.

***H_{02}*:** *There is no significant relationship between income smoothing and earnings per share of manufacturing firms in Rivers State.*

Table 2.

Spearman's Rank Order Correlation of Income Smoothing and Earnings per Share Income Earnings per Smoothing Share

			INCOME SMOOTHING	RETURN ON ASSET
		Correlation Coefficient	1.000	742
	INCOME SMOOTHING	Sig. (2-tailed)		.000
	N		110	110
Spearmans rank		Correlation coefficent	.742	1.000
	RETURN ON ASSET	Sig. (2-tailed)	.000	
	N		110	110

Correlation is significant at the 0.05 level (2-tailed)
Source: Researcher's Field Survey, 2024 (SPSS 21 Output)

The Spearman's Rank Order Correlation Coefficient (r) result of 0.742 shows that there is a strong positive relationship between income smoothing and earnings per share of manufacturing firms in Rivers State. Also, the null hypothesis two (**H_{02}**) was rejected since the significant value (P-value) of 0.000 is less than 0.05 the conclusion is that there is a significant relationship between income smoothing and earnings per share of manufacturing firms in Rivers State. This means that there is sufficient statistical evidence to conclude that income smoothing has significant positive effect on earnings per share of manufacturing firms in Rivers State.

H_{03}: There is no significant relationship between aggressive earnings management and return on asset of manufacturing firms in Rivers State.

Table 3.

Spearman's Rank Order Correlation of Aggressive Earnings Management and Return on Asset (ROA)

			INCOME SMOOTHING	RETURN ON ASSET
		Correlation Coefficient	1.000	.606
	INCOME SMOOTHING	Sig. (2-tailed)		.000
	N		110	110
Spearmans rank		Correlation coefficent	.606	1.000
	RETURN ON ASSET	Sig. (2-tailed)	.000	
	N		110	110

Correlation is significant at the 0.05 level (2-tailed)

Source: Researcher's Field Survey, 2024 (SPSS 21 Output)

The Spearman's Rank Order Correlation Coefficient (r) result of 0.606 in shows that there is a strong positive relationship between aggressive earnings management and return on asset of manufacturing firms in Rivers State. Also, the null hypothesis three (**H_{03}**) was rejected since the significant value (P-value) of 0.000 is less than 0.05. the conclusion is that there is a significant relationship between aggressive earnings management and return on asset of manufacturing firms in Rivers State. This means that there is sufficient statistical evidence to conclude that aggressive earnings management has significant positive effect on return on asset of manufacturing firms in Rivers State.

H_{04}: There is no significant relationship between aggressive earnings management and earnings per share of manufacturing firms in Rivers State.

Table 4.

Spearman's Rank Order Correlation of Aggressive Earnings Management and Earnings per Share

	INCOME SMOOTHING	RETURN ON ASSET

		Correlation Coefficient	1.000	.617
	INCOME SMOOTHING	Sig. (2-tailed)		.000
	N		110	110
Spearmans rank		Correlation coefficient	.617	1.000
	RETURN ON ASSET	Sig. (2-tailed)	.000	
	N		110	110

Correlation is significant at 0.05 level (2-tailed)
Source: Researcher's Field Survey, 2024 (SPSS 21 Output)

The Spearman's Rank Order Correlation Coefficient (r) result of 0.617 in shows that there is a strong positive relationship between aggressive earnings management and earnings per share of manufacturing firms in Rivers State. Also, the null hypothesis four (**H_{04}**) was rejected since the significant value (P-value) of 0.003 is less than 0.05. The conclusion is that there is a significant relationship between aggressive earnings management and earnings per share of manufacturing firms in Rivers State. This means that there is sufficient statistical evidence to conclude that aggressive earnings management has significant effect on earnings per share of manufacturing firms in Rivers State.

DISCUSSION OF FINDINGS

The findings align with existing literature, which suggests that creative accounting distorts financial performance, leading to risks such as corporate collapse and loss of investor trust. In the case of Rivers State, where manufacturing companies contribute significantly to the local economy, these practices pose a threat to economic stability. Stakeholders, including investors, need more transparent financial reporting and stronger regulatory oversight to mitigate these risks.

Prevalence of Creative Accounting: The study revealed that a significant number of companies engage in creative accounting, primarily to meet investor expectations and secure loans. Common practices included the overstatement of assets, income smoothing, and underreporting of liabilities.

Impact on Financial Performance: Creative accounting practices, while providing short-term financial performance boosts, were found to undermine long-term sustainability. Companies that engaged heavily in these practices showed inflated profit margins and ROA, but their liquidity ratios often reflected underlying financial distress.

CONCLUSION AND RECOMMENDATIONS

This study examined the effect of creative accounting on financial performance of manufacturing firms in Rivers State. Based on the findings, the study therefore concluded that financial performance of manufacturing firms in Rivers State is optimized and improved as a result of creative accounting.

Based on the findings of this study, the following recommendations are made:

There is the need to restore integrity and public confidence to accounting operations, the accountants should be strengthened to respond quickly to the egregious abuses and malpractice in the world of business and impose sanctions on offenders.
Creative accounting practices should be considered as a serious crime and therefore accounting bodies, law courts and other regulatory authorities need to adopt strict measures to stop the practice and punish the offenders.

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