

Effect of Creative Accounting on the Financial Performance of Listed Deposit Money Banks in Nigeria

OYEWOB Ifeoluwapo Adebimpe, OMOROGBE Osarumwense Damian

Department of Accounting, Bingham University, Karu Nasarawa State, Nigeria

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ABSTRACT

The list of recent cases of creative accounting practices is growing as many financial institutions in Nigeria are being investigated. As a result, this study examined the effect of creative accounting on the financial performance of listed deposit money banks in Nigeria. For this study, secondary data were explored, and the study adopted an ex-post facto research design. The population of this study comprised all the nineteen (19) deposit money banks listed on the Nigerian Exchange Group as of December 31 2022, and ten (10) banks were selected as sample size using purposive sampling techniques. Data were analysed using the panel multiple regression technique (fixed effect regression model) with the help of Statistical tool, E-views version 12.0. The study found that Non-performing Loans exert a positive and significant influence on the Return on Equity of the listed deposit money banks; Capital Adequacy Ratio has a negative but significant effect on Return on Equity; Gross Earnings Ratio has a positive but insignificant effect on Return on Equity; and Loan-to-asset Ratio posited a negative but significant effect of on Return on Equity. The study recommends that proactive measures to identify, assess, and mitigate credit risks can help minimise the adverse impact of non-performing loans on financial performance.

Keywords:

INTRODUCTION

Financial performance assesses organisational progress, impacting investment decisions and business strategy. Key indicators include net income, cash flow, and financial ratios like ROA and ROE. Economic conditions and business strategy influence performance, with innovations in intangible assets enhancing competitiveness (Stewart, 2020). Ismail (2020) views financial performance holistically, encompassing assets, liabilities, equity, expenses, revenue, and profitability, crucial for internal and external decision-makers. Lev and Zarowin (2021) suggest various metrics like Gross Profit Margin, Current Ratio, and Return on Equity, with this study focusing on ROE.

For banks, net margin on loans, ROE, ROA, ROI, and CAMEL rating assess performance. Creative accounting, employing advanced techniques within legal boundaries, raises ethical concerns, impacting investor trust (Amat & Gowthorpe, 2020). Financial reporting's role in corporate governance is crucial, but accounting policy choices can lead to deliberate non-disclosure and manipulation (Mulford & Comiskey, 2022). Creative accounting practices, such as revenue recognition and asset misreporting, aim to influence share prices, borrowing costs, and executive rewards (Niskanem & Kebharju, 2020). The practice is debated for its impact on development and potential deception (Mathew & Perera, 2016).

Measuring creative accounting involves indices like Sustainable Financial Data and Corporate Governance Practices, with this study focusing on NPL, CAR, GER, and LAR (Niskanem & Kebharju, 2020). Corporate

governance failures contribute to financial collapses, exemplified by past scandals like Enron and WorldCom (Ezeani, 2020). Financial statement distortions, particularly in Nigerian banks, pose ethical challenges and have led to regulatory interventions (Osazevbaru, 2022). Recent cases prompted an investigation, with changes in board members linked to alleged creative accounting (Akenbor & Ibanichuka, 2022). The rise in creative accounting in Nigerian banks threatens investor trust and the financial system's stability (Osazevbaru, 2022).

Hypotheses

In line with the objectives stated above, the following hypotheses were formulated, all stated below in null form.

Ho₁: Non-performing loans do not significantly affect the return on equity of listed deposit money banks in Nigeria.

Ho₂: Capital adequacy ratio has no significant effect on the return on equity of listed deposit money banks in Nigeria.

Ho₃: Gross earnings ratio has no significant effect on the return on equity of listed deposit money banks in Nigeria.

Ho₄: The loan-to-asset ratio does not significantly affect the return on equity of listed deposit money banks in Nigeria.

LITERATURE REVIEW

Creative Accounting

Creative accounting, also known as 'deceptive accounting,' involves practices that adhere to standard accounting rules but deviate from their intended spirit. It employs excessive compliance and innovative methods to influence income, assets, or liabilities to shape perceptions toward desired outcomes (Brijesh, 2021). First coined in 1968, the term refers to practices deviating from standard accounting, remaining within legal bounds but distorting reported figures to convey management's desired narrative to stakeholders (Okoye & James, 2020). Described as impression management, it often manifests in corporate reports through narrative distortions and numerical/graph manipulation (Mati et al., 2020).

While not illegal, creative accounting is considered immoral for misleading investors. The practices are technically authorised by the accounting system but raise ethical concerns. The roots of creative accounting date back 500 years, influenced by figures like Lucas Paciolo (Bankole et al., 2018). Accounting processes and policy choices, influenced by judgments, contribute to manipulation and challenge credibility in financial reporting (Osioma & Enahoro, 2022). Creative accounting is linked to accounting scandals, corporate governance failures, and financial collapses (Ezeani, 2020). The Enron and WorldCom scandals exemplify the damaging impact on stakeholders and the accounting profession, questioning the integrity of auditors and accountants involved.

Non-performing loans

Non-performing loans (NPLs) are loans where interest and principal payments are past due by 90 days or interest payments equal to 90 days or more have been delayed, capitalised, or refinanced. Suppose payments are less than 90 days overdue, but there are doubts about full repayment due to reasons like bankruptcy. The loan is also considered non-performing (IMF et al. on Financial Soundness Indicators, 2015). Another

definition by Ezeani et al. (2021) characterises non-performing loans and advances as credits with a deteriorated credit quality, making the full collection of principal and interest uncertain. The Central Bank of Nigeria's (CBN) prudential guidelines classify non-performing loan facilities into substandard, doubtful, and lost, based on the duration of unpaid principal and interest (Ahmed et al., 2017).

Capital Adequacy Ratio

The capital adequacy ratio measures a firm's solvency and represents the owner's equity available as a defence during adverse situations. It is calculated as total equity to total assets, and a high ratio indicates a safe and financially sound bank that can meet its obligations. Banks with low capital adequacy ratios face a higher risk of failure, often attributed to a large volume of bad loans (Turan & Koskija, 2019).

Gross Earnings Ratio

In the corporate context, gross earnings refer to a public company's gross profit, representing the amount remaining from total revenues over a specified period after deducting the cost of sales (Ezeani, 2020). Okoye and James (2020) explain that gross earnings are reported periodically on a company's income statement, appearing after total sales and revenues. The difference between revenue and the cost of goods sold (COGS) constitutes a company's gross earnings, reflecting its earnings before deductions and taxes. Lenders assess gross annual income to evaluate loan affordability, typically approving loans for up to 28% of gross annual income.

Loan-to-asset Ratio

The loan-to-asset ratio represents the relationship between the total amount of loans and total assets, indicating a firm's risk appetite and liquidity. Calculated by dividing total loans by total assets, a higher ratio signifies elevated credit levels and an increased likelihood of credit risk. This ratio is instrumental in evaluating a bank's liquidity status by comparing total loans to total deposits for the same period, concurrently measuring leverage and the liquidity of assets tied to loans (Makri et al., 2019).

Return on Equity

Return on Equity (ROE) is a key financial metric that gauges management's efficiency in generating profits from the equity capital invested in the firm. As Nedelcu (2014) notes, it represents after-tax profit as a percentage of total shareholder equity. This ratio provides insight into the effectiveness of an enterprise and its management utilising equity investment to generate returns. A higher ROE is generally preferred, as it signifies a higher rate of return for the stockholder.

Firm Size

Firm size, often synonymous with the scale or volume of a business operation, is a crucial metric influencing a company's functioning and profitability. Typically determined by indicators such as the natural logarithm of total assets, sales, or market value of equity (Krejcie & Morgan, 2021), firm size can be measured using various parameters like the number of employees, turnover, or total assets. Research indicates that firm size, as a decision factor, significantly affects a company's profitability (Atif & Malik, 2015).

EMPIRICAL REVIEW

Rajha (2023) empirically examined the effect of loan- the loan-to-asset ratio on the performance of the Jordanian banking sector. Among the bank-specific variables employed are loan-to-total asset ratio and bank

size. Data were analysed using the regression analysis technique. Findings reveal that the loan-to-assets ratio does not influence performance significantly. Results also show that large banks, in terms of total assets, need to be more efficient in assessing the credit quality of the clients, which has led to an increase in the volume of bad loans during the past years. The study recommended that the Jordanian government introduce more banking policies. The above study was conducted in the Jordanian banking sector, but this current study focuses on the Nigerian banking sector.

Osemene *et al.* (2022) conducted a study on the impact of creative accounting on insurance firms' performance in Nigeria. Data were analysed using the multiple regression analysis. The study revealed that non-performing loans are positively related to return on equity and dividend payout, while the gearing ratio and net income before tax are negatively related to both returns on equity and dividend payout. The study suggested that the Nigerian government introduce more financial policies in the sector. The findings of the above study could be spurious and unreliable. This is because the study needed to follow the procedures for analysing panel data, but this current study followed them.

Tohid *et al.* (2021) examined the role of creative accounting on the financial performance of Bangladesh commercial banks for 2011-2019 using panel data modelling. The study used a balanced panel data method to analyse bank-specific (Net-loans-to-deposit ratio, bank size, cost-to-income ratio and capital adequacy rate) and financial performance (Returns on assets). The researchers analysed historical data and panel models using secondary data. The research considered 16 private commercial banks in Bangladesh and executed the pooled Ordinary Least Square (OLS) model, fixed effect model, random effect model, and random effect with robust standard error. Findings showed a negative and significant relationship between capital adequacy rate, return-on-average assets, and net-loans-to-deposit ratio about returns on assets. The study, however, recommended some strategies for management to adopt to improve capital adequacy rate, return-on-average assets, net-loans-to-deposit ratio, and inflation rate to reduce the volume of non-performing loans to a tolerable limit. The above study was conducted in Bangladesh commercial banks from 2011-2019, but this current study focuses on the Nigerian banking sector from 2013-2022.

Chen (2021) studied whether organisations that employ creative accounting practices report higher earnings before and after tax of Nigerian deposit money banks. Data were analysed using the panel regression model. The study revealed that firms employing creative accounting practices reported smaller earnings before interest and tax values and smaller changes in earnings after interest and tax. The study suggested that the Nigerian government should introduce policies that can curtail earnings manipulations in the banking sector. The above study's findings cannot be generalised because the study needed to identify the population and the sample size of the study.

Theoretical framework

Several competing theories combine to guide discussions on creative accounting and firm performance. The competing theories resonate in agency, resource dependency, underpinning, and ethical theories.

Agency theory, developed by Berle and Means (1932), suggests that owners are concerned that managers' interests are not in unity with their own and that managers will act in ways that will prevent profit maximisation. This will potentially threaten the company's existence; thus, owners believe that such managers have great control over the firm.

Dependency theory, propounded by Pfeffer and Salancik (1990), is hinged on the notion of independence. Managers are quite dependent on shareholders because managerial compensation is frequently tied to stock price, and investors have great discretion over where they invest their capital. If shareholders were concerned with whether managers had sufficient control over their firms, this might affect how managers account for firm performance. Although managers are limited by their dependencies, they can address the

concern by increasing their perceived control (Pfeffer, 1981).

Ethical Theory. This theory was propounded by Ruland Peter in 1984. The theory states that companies generally prefer to report a steady trend of profit growth rather than to show volatile profits with dramatic rises and falls. This is achieved by making unnecessary high provisions for liabilities and against assets values in good years to reduce these provisions, thereby improving reported profits in bad years. Advocates of this approach argue that it is a measure against the ‘short-termism’ of judging an investment based on the yield achieved in the immediate following years.

METHODOLOGY

This study employs an ex-post facto research design, utilising historical data as events have already occurred and cannot be altered by the researcher. The population includes all 19 listed deposit money banks on the Nigerian Exchange Group as of December 31, 2022. A purposive sampling technique selects a sample of 10 banks based on specific criteria. Data is collected from secondary sources, mainly firms’ published annual reports from 2013-2022. Descriptive statistics, correlation analysis, and panel regression are employed for data analysis using E-views version 12.0. The study tests for fixed and random effects conducts the Hausman specification test and performs robustness tests to check for multi collinearity, heteroskedasticity, and serial correlation in the regression models.

RESULT AND DISCUSSION

Descriptive Statistics

Table 4.1 Descriptive Statistics Table

	ROE	NPL	CAR	GER	LAR	FSIZE
Mean	18.14882	9.976100	6.953200	7.351000	2.713575	7.569500
Median	18.36648	10.76000	6.810000	7.205000	1.646115	7.515000
Maximum	20.54257	22.38000	8.170000	9.310000	19.59018	8.760000
Minimum	15.73232	1.040000	6.090000	5.970000	-3.302458	6.190000
Std. Dev.	1.297655	4.876423	0.524304	0.814094	3.234959	0.685414
Skewness	-0.141935	0.071122	0.672374	0.669834	2.250085	0.044681
Kurtosis	1.903491	2.282930	2.456944	2.859814	10.02470	1.828340
Jarque-Bera	5.345472	2.226761	8.763575	7.559853	289.9917	5.753224
Probability	0.069063	0.328447	0.012503	0.022824	0.000000	0.056325
Sum	1814.882	997.6100	695.3200	735.1000	271.3575	756.9500
Sum Sq. Dev.	166.7068	2354.170	27.21458	65.61210	1036.031	46.50948
Observations	100	100	100	100	100	100

Source: E-views 12 Output (2023)

The mean values indicate that, on average, the Return on Equity (ROE) is 18.15%, the Non-Performing Loans ratio (NPL) is 9.98%, Capital Adequacy Ratio (CAR) is 6.95%, Gross Earnings Ratio (GER) is 7.35%, Loan-to-asset Ratio (LAR) is 2.71%, and Firm Size (FSIZE) is 7.57. ROE has the highest average, while LAR has the lowest.

The median values reveal a relatively symmetric distribution for ROE (18.37%), some skewness towards

higher values for NPL (10.76%), and a moderate range for the other variables. LAR shows a potential outlier. Examining the maximum and minimum values, ROE ranges from 15.73% to 20.54%, NPL from 1.04% to 22.38%, CAR from 6.09% to 8.17%, GER from 5.97% to 9.31%, LAR from -3.30% to 19.59% (indicating potential issues with negative values), and FSIZE from 6.19% to 8.76%.

Standard deviation indicates moderate variability around the mean for ROE, considerable variability for NPL, low variability for CAR, moderate variability for GER, significant variability for LAR, and moderate variability for FSIZE. Skewness is close to zero for ROE, NPL, CAR, GER, and FSIZE (approximately symmetric), while LAR has a positive skewness of 2.25, indicating a right-skewed distribution.

All variables exhibit positive kurtosis, suggesting heavier tails and potentially more outliers. LAR has the highest kurtosis. The Jarque-Bera test indicates non-normal distributions for GER and LAR, with low p-values. The sum and sum of squared deviations provide total and variance information for further calculations. There are 100 observations for each variable.

Correlation Matrix

Table 4.2: Correlation Matrix Result Table

Covariance Analysis: Ordinary						
Date: 11/11/23 Time: 12:21						
Sample: 2013 2022						
Included observations: 100						
Correlation						
Probability	ROE	NPL	CAR	GER	LAR	FSIZE
ROE	1.000000	—				
NPL	-0.563867	1.000000				
	0.0000	—				
CAR	0.141695	-0.022175	1.000000			
	0.1597	0.8267	—			
GER	0.374981	-0.296153	0.015195	1.000000		
	0.0001	0.0028	0.8807	—		
LAR	-0.189653	0.017269	0.142169	0.114677	1.000000	
	0.0588	0.8646	0.1582	0.2559	—	
FSIZE	-0.065928	-0.120080	0.137714	-0.022709	0.165130	1.000000
	0.5146	0.2340	0.1718	0.8226	0.1006	—

Source: E-views 12 Output (2023)

ROE has a strong positive correlation with GER (0.375), indicating a potential positive relationship between Return on Equity and Gross Earnings Ratio. ROE has a moderate negative correlation with NPL (-0.564), suggesting a potential negative association between Return on Equity and Non-Performing Loans ratio.

NPL shows a weak negative correlation with GER (-0.296), indicating a potential negative relationship between the Non-Performing Loans ratio and Gross Earnings Ratio. CAR exhibits weak correlations with other variables. LAR has weak correlations with other variables, except a weak positive correlation with GER (0.115). FSIZE shows weak correlations with other variables.

Variance inflation Test

Table 4.3: Result of Variance Inflation Test Table

Variance Inflation Factors			
Date: 11/11/23 Time: 12:29			
Sample: 2013 2022			
Included observations: 100			
	Coefficient	Uncentered	Centred
Variable	Variance	VIF	VIF
C	4.021649	408.6682	NA
NPL	0.000469	5.869397	1.122792
CAR	0.037423	184.8881	1.034912
GER	0.016823	93.50003	1.121660
LAR	0.001012	1.822243	1.065178
FSIZE	0.022550	132.3586	1.065732

Source: E-views 12 Output (2023)

The VIF results from the Pooled Ordinary Least Square (OLS) analysis in Table 4.3, provided in Appendix 2, indicate the absence of multicollinearity issues in the regression model. The centred VIF values for variables (NPL, CAR, GER, LAR, and FSIZE) are below 10 (ranging from 1.034912 to 1.122792), confirming the model's stability and the lack of multicollinearity concerns.

Heteroskedasticity Test

Table 4.4 Heteroskedasticity Test Table

Panel Period Heteroskedasticity			
L.R. Test			
Null hypothesis: Residuals are homoscedastic			
Equation: UNTITLED			
Specification: ROE C NPL CARGER LAR FSIZE			
	Value	Df	Probability
Likelihood ratio	8.163283	10	0.6129

Source: E-views 12 Output (2023)

Table 4.4 presents the results of the panel cross-section Heteroskedasticity regression test. The test's null hypothesis, stating the absence of Heteroskedasticity, is accepted as the corresponding probability value (0.6129) exceeds the 5% significance level. Therefore, the study rejects the alternative hypothesis, concluding no heteroskedasticity problem exists. The diagnostic probability of 0.6129 affirms the homoskedastic nature of residuals, indicating that the samples accurately reflect the population.

Hausman Test

Table 4.5: Hausman Test

Correlated Random Effects – Hausman Test			
Equation: Untitled			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	12.515842	5	0.0284

Source: E-View 12 Output (2023)

The Hausman test results indicate a chi-square statistics value of 12.515842 and a probability value of 0.0284. The r provides sufficient evidence to reject the null hypothesis, favouring the random effect model in Panel Regression analysis. The outcome suggests that the error component model (random effect) estimator could be more suitable due to the weak correlation between random effects and regressors. Therefore, the study concludes that the fixed effect regression model is more consistent and efficient for the sampled data, as the probability value is below 5%.

Fixed Effect Likelihood Ratio

Table 4.6: Fixed Effect Likelihood Ratio Table

Redundant Fixed Effects Tests			
Equation: Untitled			
Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	5.769561	(9,85)	0.0000
Cross-section Chi-square	47.678970	9	0.0000

Source: E-View 12 Output (2023)

The fixed effect likelihood ratio test reveals a chi-square statistics value of 35.653583 with a probability value of 0.0000. This provides substantial evidence to reject the null hypothesis, favouring the pooled effect model in Panel Regression analysis. The outcome suggests that the error component model (pooled effect) estimator is unsuitable, possibly due to the correlation between pooled effects and one or more regressors. Therefore, the study concludes that the fixed effect regression model is more consistent and efficient for the sampled data among the options of pooled effect and fixed effect analyses. The next step involves the Hausman test to validate the appropriateness of using the fixed or random effect models further.

Test of Hypotheses

Table 4.7: Panel Regression Result (Fixed Effect)

Dependent Variable: ROE		
Method: Panel Least Squares		
Date: 11/11/23 Time: 12:40		
Sample: 2013 2022		
Periods included: 10		

Cross-sections included: 10				
Total panel (balanced) observations: 100				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	21.96527	5.932946	3.702254	0.0004
NPL	0.064469	0.025961	-2.483275	0.0150
CAR	-1.545287	0.743104	-2.079504	0.0406
GER	0.774948	0.561978	1.378965	0.1715
LAR	-0.062993	0.029627	-2.126209	0.0364
FSIZE	0.270254	0.265931	1.016255	0.3124
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.655539	Mean dependent var	18.14882	
Adjusted R-squared	0.598804	S.D. dependent var	1.297655	
S.E. of regression	0.821935	Akaike info criterion	2.583171	
Sum squared resid	57.42408	Schwarz criterion	2.973946	
Log-likelihood	-114.1585	Hannan-Quinn criteria	2.741325	
F-statistic	11.55443	Durbin-Watson stat	1.573817	
Prob(F-statistic)	0.000000			

Source: E-View 12 Output (2023)

Table 4.7 (Panel Regression/Fixed Effect) indicates the impact of creative accounting on listed deposit money banks in Nigeria. Non-performing loans (NPL), Gross Earnings Ratio (GER), and Firm Size (FSIZE) show positive effects on Return on Equity (ROE). At the same time, Capital Adequacy Ratio (CAR) and Loan-to-asset Ratio (LAR) have negative impacts. NPL and CAR are statistically significant, while GER, LAR, and FSIZE are not. The R2 value is 0.66, indicating a 66% explanation for changes in Creative Accounting influencing ROE. Adjusted R2 is 60%, reinforcing a strong relationship. Notably, Non-Performing Loans (NPL) and Capital Adequacy Ratio (CAR) significantly affect ROE, while Gross Earnings Ratio (GER) does not. Additionally, Loan-to-asset Ratio (LAR) impacts ROE significantly, and the Prob confirms the collective influence of all variables. (F-statistic) being 0.0000, less than 0.05. Therefore, creative accounting significantly affects the financial performance of listed deposit money banks in Nigeria.

CONCLUSION AND RECOMMENDATIONS

In conclusion, the study investigated the impact of creative accounting on the financial performance of listed deposit money banks in Nigeria. The results from the panel regression analysis revealed that Non-Performing Loans (NPL) and Capital Adequacy Ratio (CAR) significantly influence Return on Equity (ROE). The Gross Earnings Ratio (GER) was statistically insignificant, while the Loan-to-asset Ratio (LAR) significantly impacts ROE. The collective effect of these variables on ROE was confirmed, emphasising the substantial influence of creative accounting practices. The findings highlight the importance of vigilance in managing Non-Performing Loans and maintaining optimal Capital Adequacy Ratios for sustainable financial performance in the banking sector.

It was recommended that:

1. Recognising the substantial impact of Non-Performing Loans (NPL) on Return on Equity (ROE),

- listed deposit money banks in Nigeria should prioritise robust risk management frameworks. Proactive measures to identify, assess, and mitigate credit risks can help minimise the adverse impact of non-performing loans on financial performance.
2. Considering the significant negative effect of Capital Adequacy Ratio (CAR) on ROE, banks should balance maintaining regulatory capital requirements with optimising profitability. Exploring strategies for efficient capital utilisation without compromising returns, such as prudent capital allocation and risk-weighted asset optimisation, is crucial.
 3. Evaluating the positive but insignificant effect of the Gross Earnings Ratio (GER) on ROE, deposit money banks should scrutinise their earnings management strategies. Enhancing revenue generation efficiency, cost management, and overall operational performance through continuous monitoring and adjustment of earnings management practices is recommended.
 4. Banks should carefully assess their loan portfolio composition in response to the negative but significant effect of the Loan-to-Asset Ratio (LAR) on ROE. Strategic loan portfolio management can improve financial performance, including diversification and focusing on high-quality assets. Exploring innovative lending practices aligned with risk appetite is essential for maintaining a healthy balance between loans and assets.

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