Corporate Governance and Creative Accounting Practice in Nigeria

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ABSTRACT

The work is a content/exploratory review of literature on corporate governance and accounting practices that contributed to various forms of corporate scandals that occurred worldwide. The key provisions of the code of corporate governance in Nigeria issued by SEC in 2011 to address corporate governance problem is also examined with a view to identifying some other variables critical to transparency in financial reporting that are not specifically stated in the code. Drawing from existing studies, it was discovered that good corporate governance also thrives in some other transparency variables not specifically mentioned in the code. The study, therefore, recommends some measures, among which is the use of simple language as opposed to technical terms in financial reports of companies. This is necessary for understandability and transparency. Transparency is a key variable in corporate governance.

Keywords: Corporate governance, transparency, creative accounting, financial reporting, confidence

INTRODUCTION

Corporate Organizations have become a powerful and dominant institution critical to the development of any economy. Their governance has, therefore, influenced economies worldwide in terms of growth and development. The confidence of the general public in corporate organizations started dwindling from 1990s due to various forms of financial scandals that culminated in the failure of many large corporate entities worldwide. Poor corporate governance and fraudulent financial reporting done through creative accounting practice are largely responsible for the failure. Sanusi (2012) observes that the impact of good corporate governance on the growth of any economy can be related not only in the size of investment but also the way and manner such investments are managed in terms of efficiency and transparency.

In recent times, the world witnessed the distress and failure of large corporate organizations attributed to lack of transparency, accountability and poor corporate governance on the part of directors of those organizations in connivance with their auditors. These eroded the confidence of the public and shareholders in the financial statement prepared by management of enterprise. Normally, financial statement prepared by directors (management) is a potent means for reporting and communicating the activities and financial

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position of an entity. In most cases, the statements are manipulated to suit the various purposes of directors and other management staff. It is quite unfortunate, therefore, that directors and other management staff entrusted with the daily affairs of running an enterprise see accounting guidelines and regulations as rules to be circumvented by putting auditors under increasing commercial pressure in a manner such that creative accounting becomes the order of the day. Lai and Bello (2012) observe that corporate governance is a way of life that necessitates taking interest of all stakeholders into consideration in every business decision and not a set of rules that can be changed at the whims and caprices of those in charge of the affairs of corporate organizations. Transparency is, therefore, a key ingredient required of the board of directors in reporting the operations of an enterprise to all and sundry particularly the shareholders who have made investment of their wealth in a company. Transparency, therefore, is central to good corporate governance which incorporates a system of checks and balances between board of management and auditors on the one hand and shareholders on the other hand (Jayashere, 2006).

Conflict of interests are abound both within and outside an entity. Odia and Ogiedu (2013) observe that companies are usually fraught with many conflicting interests even between shareholders themselves as minority shareholders are not free from the exploitative tendencies of the majority shareholders. Majority shareholders do often exert their domineering influence on the board to manipulate financial information according to their desire to the disadvantage of the rest of stakeholders including minority stakeholders. Corporate governance, therefore, is concerned with the manner in which stakeholders in an enterprise attempt to ensure that company directors and other insiders take appropriate measures or adopt mechanisms that will safeguard the interests of all. The viable mechanisms include strict adherence to the code of best practices on corporate governance and application of transparency enhancement/inducement variables in financial reporting.

In Nigeria, corporate governance is dealt with partly in the company’s legislation (CAMA) but has been developed by independent committees which produced series of reports namely; Cadbury report, Greenbury report and Hampel report. The Cadbury report was set up mainly to address the issue of lack of confidence perceived to exist in financial reporting by members of the public due to inability of the auditor to provide the needed assurance service. The Greenbury committee was set up in light of continuing public disquiet about the excessive amounts that directors pay themselves in the face of falling company results and lack of transparency of directors in terms of inadequate disclosure of their remuneration. It was Hampel committee report that actually emphasized the need for corporate governance to be in place in corporate organizations. The report further highlights the positive contributions of good corporate governance which include stability and growth of a company, among others.

In countries like United Kingdom and United States, there is political will for improvements in corporate governance backed up with certain measures of statutory authority. In Nigeria however, corporate governance is largely hinged on self regulation having been left in the hands of business world, shareholders and investors who always bring pressure to bear upon company to improve on corporate governance.
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Corporate governance refers to the system by which the affairs of companies are directed and controlled by those charged with the responsibility. Lai and Bello (2012) observe that corporate governance hinges on a clear-cut process of directing and controlling the whole essence of companies based on transparency. Transparency as a basic principle of corporate governance literally means “openness” in all ramifications in conducting the affairs of an entity in the interest of all stakeholders. Oladimeji (2007) views corporate governance as a means of improving economic efficiency of an entity and incorporates a set of relationship among a company’s management, shareholders and other stakeholders.

Wilson (2006) defines corporate governance as a manner in which corporations are directed, controlled and held to account for their stewardship. Corporate governance involves a set of processes, customs, policies, laws, mechanisms and institutions affecting the way a corporate entity is directed, administered or controlled as stated by Organization for Economic Cooperative Development (OECD, 2004). Egenson (2001) however, views corporate governance as safeguards against corruption, mismanagement, corporate wrong doings and frauds. Good corporate governance, therefore, seeks to promote effective risk management, transparency, integrity and accountability of managers of corporate enterprises. Haslinda and Benedict (2009) viewed corporate governance as a set of processes and structures for controlling and directing an organization. It constitutes a set of rules which governs the relationship between management, shareholders and other stakeholders in an enterprise (Ching, Tan and Chiching, 2006). Haslinda and Benedict (2009) trace the origin of corporate governance from a Greek word “Kyberman” meaning to steer, guide or govern. In Latin it was known as “gubernare” and the French version is “gouvernier”.

Corporate governance is concerned with the process of decision making and the process by which those decisions are implemented in the interest of all stakeholders (Abu-Tapanjeb, 2008). Isele and Ugoji (2009) view corporate governance as the process by which managers provide leadership and direction, create enabling climate and link systematized, collaborative efforts to work groups. Corporate governance thrives on honesty, trust, integrity, complete transparency, accountability and responsibility which are referred to as the essential ingredients of corporate governance (Egenson, 2001).

Absence of the above ingredients paves way for creative accounting practice. Akenbor and Ibanichuka (2012) describe creative accounting as accepted accounting techniques which permit corporations to report financial results that may not accurately portray the substance of their business activity. For instance, a creative accountant has opportunity to err on the side of caution or optimism in estimating the useful life of an asset. It is a negative creation designed to prepare the financial statements in response to management requirement regarding company’s financial position and performance (Odia and Ogiedu, 2013). Naser (1993) views creative accounting as the transformation of financial accounting figures from what they actually are, to what preparers’ desired by taking advantage of the existing rules, and/or ignoring some or all of them. It is an undesirable practice which assimilates unethically elements for attracting providers of capital by
presenting a misleading and deceptive state of a firm’s affairs (Madu and Matis, 2010). Okoye and Alao (2008) view creative accounting as an accounting practice that tends to circumvent albeit cleverly or manipulate the rules of standard accounting practice.

The various forms of creative accounting practices as given by Odia and Ogiedu (2013) include, window dressing, income smoothing, balance sheet manipulation, account manipulation, frequent changes in accounting policies or methods and wrong use of materiality concept to justify error. Other forms/types of creative accounting practices as given by Amat, Blake, Dowds (1999) include share value boosting in order to help company raise capital from new share issues and delaying market information thereby enhancing management’s opportunity to benefit from inside knowledge for various reasons. Management’s desire to increase investors confidence through their ability to report stable earnings is another reason (Heyworth, 1953). Other reasons for creative accounting practice as given by Sulton (2000) include company’s desire to reduce tax and regulatory burden, management’s desire to raise capital more cheaply from the market and quest to increase shareholders’ wealth (Sulton, 2000). Gramlich, McAnally and Thomas (2001) opine that companies may engage in balance sheet manipulation in order to reclassify liabilities to smoothen reported liquidity and leverage ratios.

The practice of creative accounting has the power to distort the underlying financial performance of a firm (Odia and Ogiedu, 2013). Financial performance distortion through creative accounting practice incapacitates investors to assess the performance of a firm. The problem of performance assessment posed by creative accounting practice becomes more complicated especially for those investors who lack the required skill to analyze financial statements. Recurring manipulation, alteration and falsification of company accounts is a global phenomena done through creative accounting practice. The practice is largely responsible for most corporate frauds, accounting scandals and corporate failures in many developed and developing nations like U.K, U.S and Nigeria (See Tables 1).

**Table 1:** List of world class companies noted for various forms of financial scandals that eroded the confidence of investors in corporate organizations.

<table>
<thead>
<tr>
<th>Company</th>
<th>Year</th>
<th>Nature of Fraudulent Practice</th>
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<tbody>
<tr>
<td>Enron</td>
<td>2001</td>
<td>Involved in special purpose entities transactions</td>
</tr>
<tr>
<td>Global Crossing</td>
<td>2002</td>
<td>Overstated revenue and earnings above network capacity swaps.</td>
</tr>
<tr>
<td>Worldcom</td>
<td>2002</td>
<td>Covering and recording of improper expenses overstated cash flows.</td>
</tr>
<tr>
<td>Tyco</td>
<td>2002</td>
<td>Conglomerate with questionable practices on accounting for auctions and other issues.</td>
</tr>
<tr>
<td>Adelphia</td>
<td>2002</td>
<td>Overstated earnings.</td>
</tr>
<tr>
<td>Imdone</td>
<td>2002</td>
<td>Insider trading.</td>
</tr>
<tr>
<td>Health-South</td>
<td>2003</td>
<td>Overstated earnings and assets.</td>
</tr>
<tr>
<td>Krispy Krene</td>
<td>2005</td>
<td>Inflation of earnings.</td>
</tr>
<tr>
<td>Anglo Irish Bank</td>
<td>2008</td>
<td>Hidden loan controversy</td>
</tr>
<tr>
<td>Satyam Computer Service</td>
<td>2009</td>
<td>Falsified accounts.</td>
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</tbody>
</table>

*Source: Odia and Ogiedu (2013).*

Factors such as reckless use of depositors’ funds, share price valuation, poor corporate governance, high profile amount of unsecured loans and abuse of power/position by top executives among others led to the liquidation of majority of Nigerian banks in recent time. In United Kingdom, development in Corporate Governance Codes is attempt...
to address Corporate leadership failures in public organizations (Peter and Eyesan, 2015). For instance, in UK, Code of Corporate Governance (2010) states that there should be an effective board which is collectively responsible for the success of the company and a clear division of responsibility at the head of the company (Peter and Eyesan, 2015). The separation of duties will lead to avoidance of the Chief Executive Officer’s (CEO) entrenchment and availability of the board chairman to advise the CEO (Baysinger and Hoskinsson, 1990; Fama and Jayson, 2006). In light of the above therefore, the UK new code recommends fairness and equity in board composition for a vibrant and independent board (Baysinger and Hoskinsson, 1990). Various studies conducted argue that CEO/Chairman duality is detrimental to compare fairness in reporting their operations to stakeholders (Japhtta, 2009).

Table 2: List of some liquidated Banks in Nigeria due to various forms of fraudulent financial practices.

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
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<tr>
<td>Alpha Merchant Bank Plc</td>
<td>1994</td>
</tr>
<tr>
<td>United Commercial Bank Ltd</td>
<td>1994</td>
</tr>
<tr>
<td>Kapital Merchant Bank Ltd</td>
<td>1994</td>
</tr>
<tr>
<td>Republic Plc</td>
<td>1995</td>
</tr>
<tr>
<td>United Commercial Bank Ltd</td>
<td>1994</td>
</tr>
<tr>
<td>North South Bank Plc</td>
<td>1998</td>
</tr>
<tr>
<td>Ivory Merchant Bank</td>
<td>2000</td>
</tr>
<tr>
<td>Lead Bank Plc</td>
<td>2000</td>
</tr>
<tr>
<td>Gulf Bank Plc</td>
<td>2006</td>
</tr>
<tr>
<td>Hallmark Bank Plc</td>
<td>2006</td>
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<tr>
<td>Assurance Bank of Nigeria Plc</td>
<td>2006</td>
</tr>
<tr>
<td>City Express Bank Plc</td>
<td>2006</td>
</tr>
<tr>
<td>Metropolitan Bank Ltd</td>
<td>2006</td>
</tr>
<tr>
<td>Liberty Bank Plc</td>
<td>2006</td>
</tr>
</tbody>
</table>

Source: Cowry Asset Management Limited, 2009. In line with the world best practice therefore, the Nigerian code of Corporate Governance (CCG) (2011) was issued by the Nigerian Securities and Exchange Commission (SEC) to address some of the loopholes in the corporate governance code of 2003 and 2006. Essentially, the provisions of the 2011 SEC code focused on Corporate Governance Law, Business and other incidental matters (Peter and Eyesan, 2015). Among the various Good Governance variables addressed by the code include board size, enterprise risk management and CEO duality and corporate disclosure reports (Okafor and Ibadin, 2011). The size refers to the board structure of the appropriate mix of directors in terms of expertise that will bring their experiences to bear for the attainment of organizational goal (CCG, 2011). Enterprise Risk Management disclose of the code requires Corporate Managers to incorporate and disclose their operative strategic risk and risk management function to attain organizational goals. The disclosure reports as enshrined in the code approve of the separation of powers between the chairman of the board and CEO based on agency theory (Abdul-Rahaman and Haniffa, 2005). It is argued that...
CEOs who also hold the position of the board chairman (duality) exerts undue influence on the board, compromising and weakening the strength of the board’s governance (Peter and Eyasan, 2015). This position however contradicts that of Davis, Schoorman and Donaldson (1997) and Donaldson and Davis (1991) who believe that CEO-Chairman duality will enable companies attain internal efficiencies through unity of command, eliminate potentials for conflict between CEO and board chair and avoid incompetence that characterizes spokespersons addressing company stakeholders. For balance of power and authority however, the Nigerian code of Corporate governance 2011 approves of position separation between the position of the CEO and chairman which is consistent with U.K Corporate Governance Code 2010 and Financial Reporting Council (FRC) 2010. Good corporate governance thrives on equity, an independent board and transparency in financial reporting (Eisenberg, Sundgrea and Wells, 1998).

Transparency is key to corporate governance (Wilson 2006, Jayashree 2006 and Lai and Bello, 2002). Transparency measures ensure the use of simple language in reports as oppose to use of technical terms for clarity. Brevity and prompt production and delivery of reports having both predictive and feedback value though not specifically measured by the code are also necessary in financial reporting (Nmesirionye and Ozor, 2011). The Predictive value of a financial report helps decision makers to either confirm or correct prior expectations while feedback value generally improves decision makers’ abilities to predict the result of similar future actions (Nmesirionye and Ozor, 2011). Transparency is a virtue that places both moral as well as statutory burden in most cases on employees (the board) of companies to refrain from accounting practices that will undermine the true and fair reporting of financial position of companies to all stakeholders.

**Theoretical Framework**

This study was anchored on Agency theory Alchian and Demsetz (1972) further developed by Jensen and Meckling (1976), stewardship theory Davis, Schoorman and Donaldson (1997) and stakeholder theory Freeman (1984). Agency theory posits that relationship exists between the principal and agent(s). In this theory, shareholders who are the owners or principals of company hire agents (managers) to perform work. Principals delegate the running of business to the directors or managers who are the shareholders’ agent (Clarke, 2009). Shareholders expect agents to act and make decisions in their interest. On the contrary however, agent(s) may not in some cases make decisions in the best interests of the principals (Padilla, 2000). Such a problem was first identified by Adam Smith in the 18th Century and further explored by Ross (1973) with a detailed description of the theory by Jensen and Meckling (1976).

In agency theory, the agent may be succumbed to self-interest and opportunistic behaviour falling short of congruence between the aspirations of the principal and the agents pursuit (Haslida and Benedict, 2009). Agency theory was introduced basically as a result of separation between ownership and control (Bhimani, 2008). The agency model as developed in the agency theory by Jensen and Meckling (1976) can be applied to align the goals of management with that of owners. The theory prescribes that employees are to be held accountable in their tasks and responsibilities. Employees must, therefore, constitute
a good governance structure rather than just providing the need of shareholders which may be challenging the governance structure.

Stewardship theory, unlike agency theory, stresses not only on the perspective of individualism (Donaldson and Davis, 1991) but rather on the role of managers as stewards integrating/aligning their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained. The theory stresses on the position of employees and company executives to act more autonomously so that the shareholders’ returns are maximized (Haslinda and Benedict, 2009). Donaldson and Davis (1991) further argue that in order to protect their reputations as decision makers in organizations, company managers and directors are inclined to operate the firm to maximize financial performance as well as shareholders profits. The theory suggests unifying the role/function of CEO and chairman in order to reduce agency costs and to have more roles as stewards in organizations.

It was suggested however that company returns will tremendously improve by having both theories (Agency and stewardship) combined rather than separated (Donaldson and Davis, 1991). Stakeholders theory developed by Freeman (1984) incorporates corporate responsibility and accountability to a broad range of stakeholders. The theory defines stakeholders as any group of persons or individuals who can be affected or is affected by the achievement of an organization’s objectives. The theory suggests that managers in an organization have a network of relationships to serve (this include suppliers, employees and business partners). The theory further argues that this group of network is rather more important than owner-manager-employee relationship in agency theory (Freeman, 1991). Sundaram and Inkpen (2004) suggest that stakeholder theory attempts to address group of stakeholders requiring and deserving management attention. Donaldson and Preston (1995) state that all groups participate in a business to obtain benefits. Clarkson (1995) suggests further that a firm is a system where stakeholders exists and the purpose of an organization is to create wealth for its stakeholders. Stakeholder theory is, therefore, a focus on managerial decisions and interests of all stakeholders. Stakeholders’ interest, therefore, is of paramount and must be fairly recognized by managers as no particular interest(s) is/are more important than others.

CONCLUSION AND RECOMMENDATIONS

From literature on corporate governance, a lot has been said about the need for balance of power between the position of CEO and chairman of the board by separating their roles. This is found in the Nigerian Code of Corporate Governance 2011 in line with world best practices. However, other transparency variables such as use of simple language in financial reports, the need for brevity and timely production of financial reports of enterprises are not specially mentioned in the code but are also necessary in corporate governance process. Good Corporate Governance thrives in transparency in financial reporting devoid of accounting practices that are detrimental to the interest of all stakeholders. The major objective of accounting is to communicate information to users. Quality decision making,
therefore, is based on the quality of information made available to investors in the annual reports of companies. For transparency in financial reporting which is key in Corporate Governance, companies should as much as possible use simple language in their financial reports. However, where the use of technical terms cannot be avoided, the terms should be clearly explained for understandability especially for those who are not versed in accounting terms. Accounting practices that are detrimental to true and fair financial reporting are often hidden in technical terms. To ensure improved decision making, accounting/financial report should be as brief, concise and consistent as possible without loss of details otherwise, it becomes meaningless or repulsive to users who do not have good numerical background. Finally, production and delivery of financial reports of companies should be properly timed. This will enable the users gain useful insight into the operations of the business at the needed period for prompt decision making.

REFERENCES


