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Measurement And Assessment Of Business Income And Performance In Nigeria In The Era Of Creative Accounting Practice

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ABSTRACT

Business growth in a developing economy is largely depending on the extent of the deployment and utilization of their resources human, capital and otherwise in order to maximise profit of the firm. The change in company's income (profit) from year to year has influence on the differences in the approaches adopted by accounting practitioners in reporting business income and thereby influencing reported income. The difference accounting policies, approaches and procedures adopted by accounting practitioners and preparers of financial statements create differences in the measurement, assessment and interpretation of business income through provision and loopholes in International Financial Reporting Standards (IFRSs) that lead to manipulation of financial numbers usually within the letter of the law and accounting Standards. Creative accounting practice employed by preparers of financial statements increase or decrease of depreciation, stock valuation method, and lease recognition; for tax purpose, smoothening income et al has created wide gap in the measurement and assessment of business income and performance due to the selfish interest of few stakeholders to the detriment of the larger society. Cash flow should be used to access and measure entities performance because it is more reliable and more difficult to manipulate than statement of financial performance.

Key words: Creative accounting; Income measurement; International Financial Reporting Standards (IFRSs); Business income; Financial Statement; Income volatility.

INTRODUCTION

Business growth in a developing economy is largely depending on the extent of the deployment and utilization of their resources human, capital and otherwise in order to maximise profit of the firm. Profit is a financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, cost, and taxes needed to sustain the activity. Any profit that is gained goes to the business's owner, who may or may not decide to spend it on the business. Profit is the revenue remaining after all costs are paid (Kimberly, 2019). These costs include labour, materials, interest on debt, and taxes. Most often, users of similar products and services rate these products differently based on the

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reputation of the firm that produce them. But the question is does this brand imaging associate with superior products and services of business establishments could as well extend to a professional issue like the definition of business income. Company accounts are subjected to detailed regulations of the Companies and Allied Matters Act 1990 and other specialized Acts. In addition, statements of accounting standards both local and international are equally issued to monitor the preparation of company accounts (Ofegbu, 2003). This implies that compliance with the laws is required as well as observance of the standards which help in streamlining differences in the preparation and presentation of the company accounts. The Act provides guidelines for keeping of accounting records and preparation of financial statements. For instance section 331(1) provides that every company should keep sufficient accounting records that will show and explain transactions of the company. The records will be such that will be able to disclose with reasonable accuracy the financial position of the company at any time.

They shall be such that will enable the directors to be able to prepare financial statements that will comply with the requirements of Companies Act as to the form and content of the company's financial statements. This means that in keeping financial records of transactions, the provisions of the decree must be borne in mind so as to do that within the stipulations of the law. Financial statements are the end products of all financial transactions and records of the financial company, at the end of every financial period, the shareholders, creditors, debenture holders, investors, the government or its agencies, the employees, the management, other interest groups and the public at large look forward to seeing a summary result of operations of the company in order to satisfy their different desires generated by their various interests in the company. The directors have the responsibility of presenting to the shareholders, the result of the operational performance during the financial year; although as a management group they are required to do that. Section 334(1) of CAMA, 1990, states that it is the duty of the directors of the company to prepare annual accounts at the end of each financial year of the existence of the company. Preparations of these financial s are statement r Accounting regulated by various Acts and Standards.

The Nigeria economy is one of such developing economies grappling with a lot of economic and social problems, among others inclusive in the myriad of problems are inflation of assorted types (cost push, Demand pull, et al), poverty of several dimensions confronting a large majority of their populations, insecurity due to the activities of armed robbers and the like, under-developed agricultural system, low level of technological development, dwindling manufacturing activity, general low standard of living et al (Onwumere, 2005). As the country forges ahead in its developmental efforts, the enterprises within its whether manufacturing, agricultural, distribution, service-oriented or otherwise must play vital role in preparation and presentation of income statement and financial position that show true and fair view of enterprises in other not to mislead interested stakeholders. There are different approaches used by accounting practitioners to derive accounting income of different forms of business organizations namely, sole proprietorship, partnerships, and incorporated forms of businesses.

However, most literature reviewed focused on the tax laws, the relevant and professional accounting organizations as the major influence of financial reporting of business enterprises in Nigeria and item influencing reported income. These studies have failed to consider income volatility risk as one of the major variables in determining factors that influence financial reporting of business enterprises. The primary objective of this paper/study is therefore, to examine the effect of income volatility on financial reporting of business enterprises.

THEORITICAL FRAMEWORK

The determination and measurement of business income are primarily guided by statute. However, the determination and derivation of business income are fundamentally underlie by theoretical accounting principles and concepts.

Concept of income

Marquis (2019), contend that accounting income is distinct from cash flows; particularly money a business has in its coffers at the end of given period such as a month or fiscal year. Various regulatory guidelines highlight these distinctions, telling business how to record and report revenue and expenses data. These guidelines primarily come from the Financial Accounting Standard Board, the Nigeria Securities and Exchange Commission and the Institute of Chartered Accountants of Nigeria.

However, readers of financial statements should understand the approaches used by the accountant to produce the income amount. Income is the money that an individual, region/country earns in a year as a result of investing in a business (Okafor, 2009). Therefore, the measuring could be more appreciated by understanding the usefulness of business income than by merely interpreting and understanding the items that go into the computation of accounting income (Okafor, 2009). Accounting income can be defined as estimate of performance in the operations of a company (James, 2013). It is influenced by financing and investing decisions. Accounting income or loss generally recognizes realized gains and losses, and does not recognize unrealized gains and losses. For income to be realized it must be related to actual business transactions; in effect, the cash you have must increase or decrease. A change in market value rather than cash received is not an accounting income; it is an economic income or loss recognizes all gains and losses whether realized or unrealized.

Essentially, accounting income defined the ways companies evaluate their cash standing after the sale of an asset. This once again, differs from economic income in that economic income is the way for companies to account for changes in the value of a given asset in the market .The deciding factor is whether or not a transaction takes place.

According to Hendreksen (1977), industrialists regard any organization that produces income in excess of its total costs as profitable. Profit indicates some measure of efficiency in the application of human, financial and material resources. Any organization that wastes these resources is rarely profitable.

According to Lewis et al, (1872), profits constitute the evidence that corporate operations have resulted in an increase in national wealth. Profitability in banking is closely associated with a bank's ability to stand up to creditors demand (Okafor, 1983) and in terms of granting of loans and advances (Wood and porters, 1979).

ACCOUNTING CONSERVATISM

Accounting income or loss does not incorporate unrealized gain and losses because of the convention of accounting conservatism. When accountants confront uncertainty in regard to method or procedure, they conventionally choose the option that is least likely to overstate income or asset value. In the case of realised versus unrealised gains and losses, it is more conservative from an accounting perspective to exclude increases or decreases in value that have not been actualized .According to Larson (1988:342), the conservatism principle is the accounting principle that guide accountants to select the less optimistic estimate when two estimates of amounts to be received or paid are about equally likely. Accountants by this principle are supposed to be optimistic in anticipating profits but very eager in recognising all losses no matter how far-fetched they may be (Ugwoke,2010).Thus, only profits that have actually been earned are recognised and recorded. But losses that are only contingent are equally immediately recognised and recorded

INCOME MEASUREMENT

Income measurement raises many conceptual and practical problems .For instance, the generally accepted accounting practices permit inconsistencies in the measurement of periodic income of different forms and even between different years for the same firm. For users of financial statements to understand the concept of business income, attempt should be made to understand and interpret transaction data that make up the entire records in the book of account (Okafor, 2009).

Accounting in any business establishment is perceived as a primary tool by which data relating to economic activities are measured, recorded and communicated to interested parties (Inaga, 1985). Communicating information on economic activities of a profit – oriented establishment implies reporting on its financial results. As commonly understood it is giving information on financial statements which includes statement of financial performance/profit and loss account and statement of financial position, and with respect to prevailing significant accounting. Such significant accounting policies may include basis of accounting, treatment of items involving foreign currencies, income recognition, treatment of property and equipment, revaluation of assets, depreciation of assets, stock valuation and others.

The statement of financial performance/profit and loss account is a form of data presentation, showing the summation of many positive and negative items that go into the computation (Okafor, 2009). Data so derived is from the economic environment which is influenced greatly by suppliers, customers, credit institutions, government, shareholders and the social, political, and cultural environment where the business is located. Financial reporting is the provision of financial information about an entity to external users that is useful to them in making economic decision and for assessing the effectiveness of the entity. Financial

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reporting is of two types namely; management reporting and corporate reporting. Corporate reporting refers to audited accounts which are published externally as distinct from management reporting which is designed for internal use to manage the business. In corporate reporting, it is mandatory on even publicly quoted firm to comply with the regulatory framework of reporting income statement/ statement of financial performance for the year ended with reference date. However, the popular reference date in Nigeria is December 31.

CONCEPT OF TRUE AND FAIR VIEW

According to Ofegbu 2003, for financial statements to show a true and fair view of profit and loss account and of the balance sheet, the following must been observed in their preparation.

a. The general accepted accounting practice (GAAP) as codified in IAS and SAS must be complied with in the preparation of the accounts.
b. A satisfactory reason must be given for any deviation from the accounting standard or a different accounting policy adopted while preparing the accounts.
c. There must be relevant, reliable and sufficient evidence that transactions contained in the financial records are complete, accurate and valid.
d. There is no material misstatement as a result of errors and frauds in the financial statements.
e. Relevant provisions of the Company and Allied Matters Act (CAMA) and other relevant regulations have been observed in preparation of the financial statements.

However, the concept of true and fair view of financial statement has been eroded due to the exploitation of loopholes in the accounting standards and other financial regulations. Following the law (regulations), the standards (IAS$_S$, IFRS$_S$) and the recommended practice, and even with the results audited by external companies, the scope for creative accounting remains large.

CREATIVE ACCOUNTING

The accounting process consists of dealing with many matters of judgement and of resolving conflicts between competing approaches to the presentation of the financial events and transactions………….this flexibility provides opportunities for manipulation, deceit and misrepresentation (Michael Jameson, 1988). Creating accounting constitutes the instrument for fraudulent financial reporting that entails intentional misstatement by corporate management of financial result in order to mislead investors and other users of financial reports is considered as universal phenomenon (Akhidime et al, 2014). The shareholders and market reaction is related and more to managers' actions and directors are increasingly judged on profit, growth and Earnings per share (EPS) and have large bonuses at stake. So companies (and directors) want to use the report to present the message they want investors to see, and at times this needs to creative accounting.

PREVENTION OF CREATIVE ACCOUNTING

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Those companies most at risk for fraudulent financial reporting tend to be those that have one or more of the following: week internal control; no audit committee; a family relationship among directors and/or officers; assets and revenue less than $100 million; and /or a board of directors dominated by individuals with significant equity ownership and little experience serving as directors of the companies. To prevent creative accounting, the experts opine that accountant s and managers should be dividing the duties of an internal control checklist.

Furthermore, an independent audit committee should always have someone with a strong accounting background and audit experience who deals directly with outside auditors. The investors should diversify their investment portfolio to circumvent the problem related to the creative accounting by few unscrupulous companies. Companies have to adhere strictly to the ethical values with the long-run and short-run of the life of the company. The accounting and accounting practices have to be consistent and show to investors that it is following the ethical practices in all its financial dealing as well as reporting.

According to Mulford, the expert in the field; the most common creative accounting practices include improper revenue recognition and misreporting expenses. Creating accounting has long been a long practice among companies in Nigeria, traces the motives behind the practice to selfish interest of few stakeholders to the detriment of the common good of the larger society (Akhinime et al, 2014). Measures for the curtailment of the practice are found to lie in the collaborative efforts of the professional accounting bodies, accounting training institutions, the government and the judiciary (Akhidme et al, 2014).

ITEMS INLUENCING REPORTED INCOME

The determination of profit/income is often complicated because of the interplay of depreciation, the diversity of revaluation procedures, different stock valuation methods and the tax provisions (Okafor, 2009). Depreciation is deducted from gross profit before arriving at the profit before interest and tax, but the method of calculating depreciation of assets varies from firm to firm because some firms use the straight line method, while others prefer the reducing balance method or other methods; choice of method is usually influenced by the motive of the result influence in the financial report. Certainly different methods of depreciation yield different expenditure figures which ultimately produce different figures of profit after interest and tax. In addition, there are factors that affect the calculation and apportionment of annual depreciation. Examples of such factors are the cost of the asset which is known and the useful life of the asset as well as the residual value of the asset which are matters of estimation (In real life situations, estimates of depreciation charges are rarely exact (Okafor, 2009).

Revenue generated from asset revaluation in the form of capital gain is sometimes included in profits and yet, firms differ substantially in their approach to the revaluation of asset. Revenue can be recognized on sales basis, on cash basis or on a percentage of completion of contract basis (Hendriksen, 1977). Difference arising from these different income recognition methods could therefore, result in differences in the amount of accounting income reported.

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Different inventory valuation methods- such as FIFO, LIFO, and Weighted Average Method- can affect your bottom line in different ways, so it's important to choose the right method for your business. According to the First-in-first-out (FIFO) inventory valuation method, its assume that inventory items are sold in the order in which they are manufactured or purchased. In other words, the oldest inventory items are sold first. The FIFO method is widely used because companies typically sell products in the order in which they are produced, so it best represents the actual flow of goods in a business. On the contrary, Bastable and Meriwether (1975) in their article ''FIFO in an inflationary Environment'' demonstrated how FIFO overstates accounting income during periods of high inflation when compared with the use of current replacement cost. With the Weighted Average inventory valuation method, inventory and Cost of goods sold (COGS) are based on average cost of all items purchased during a period. This method is usually used when a business doesn't have much variation in its inventory. The last-in-first-out (LIFO) inventory valuation method assumes that the most recent purchased or manufactured items are sold first. When the prices of goods increase, cost of goods in the LIFO method is relatively higher and ending inventory balance is relatively lower.

Difference stock valuation approaches produce difference results for cost of sales and consequently different profit results. For instance the Last in First out (LIFO) method reflect historical price which make the method completely meaningless for the evaluation of current performance.

Another area of creative accounting practice by directors in the preparation of financial statement is recognition of finance lease as operating lease. The approach of IAS 17 was to distinguish between two types of lease. Leases that transfer substantially all the risks and rewards of ownership of an asset were classified as finance leases. All other leases were classified as operating leases. The classification set out in IAS 17 was subjective and there was a clear incentive for the preparers of lease's financial statements to 'argue' that leases should be classified as operating rather than finance lease in order to enable leased assets and liabilities to be left out of the financial statements. It was for this reason that IFRS 16 was introduced. IFRS 16 defines a lease as ''A contract, or part of a contract, that conveys the right to use an assets for a period of time in exchange for consideration''. In order for such a contract to exist the user of the assets needs to have the right to: (a) Obtain substantially all of the economic benefits from the use of the assets. (b) The right to direct the use of the asset.

INSTITUTIONAL INFLUENCES

Companies keep proper books of accounts in accordance with generally accepted accounting principles. Similarly, financial statements are prepared in conformity with procedures and formats prescribed by relevant statutes. Accounting income measured is taxed according to the tax provisions, while the professional accounting bodies are legally authorized to prescribe methods for handling accounting matters of business establishment (Okafor, 2009).

The Companies and Allied Matters Act 1990 (CAMA) as amended is the principle legislation that regulates the operation of Nigerian companies. The accounts so prepared by

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companies are in the manner so required and in compliance with the Statements of Accounting Standards issued by the Nigerian Accounting Standards Board. The law regulating the taxation of profits of companies operating in Nigeria (excluding those involved in upstream petroleum activities) is the Company Income Tax Act (CITA) as amended by the Financial (Miscellaneous Provisions) Act Cap. 354, LFN 1990 as amended is the tax law under which companies engaged in upstream sector of the petroleum industry are assessed for tax purposes (Okafor, 2009). Oil companies operating in the downstream sector are assessed tax under the CITA cap. 60 LFN 1990 (SAS 19 paragraph 7). However, oil companies whose activities involve marketing of petroleum products or refined oils are not taxed under PPT but not CITA. Tax liability is calculated on chargeable profit.

The federal Inland Revenue Service (FIRS) officially identified as the Federal Board of Inland Revenue (FBIR) administers the taxation of companies in Nigeria. The Board is responsible to the Federal Ministry of Finance, which superintends over company tax, among other things, on behalf of the Federal Government. The tax year runs from 1st January to 31st December the same year and the tax is collected on preceding year basis (PYB). Profit can only be taxed on actual year basis when the commencement, cessation or changes of accounting period provisions are being applied.

According to Aspen institute, Volatility is about change and unpredictability. Knowing a volatile person means not knowing well what he or she will do next. Volatility in financial parlance usually refers to how much an asset's value fluctuates from its general trend; high volatility equals greater uncertainty about what the value will be tomorrow or next month or next year.
Looking at a firm's financial statements. An income and expense report would track what is coming in from earnings and benefit payments (and perhaps interest or other returns on investment) and what is going out in expenditures for today and payments on long-term obligations (perhaps a mortgage or student loans). There would also be a balance sheet of what is owned and what is owed. When those hypothetical financial statements are in flux – especially when the changes are unwanted, frequent, or unpredictable – the firm finds itself on shaky economic footing. It experiences volatility.

In the context of business finances, volatility is usually defined as the variance of income, meaning the amount of divergence from the average. It can also be measured by the number of substantial spikes and dips in income over time.

CONCLUSION

The differences accounting policies, approaches and procedures adopted by accounting practitioners and preparer of financial statements in the measurement and reportage of business income create wide differences in the measurement, assessment and interpretation of business income through provision and loopholes in International Financial Reporting Standards (IFRSs) that lead to manipulation of financial numbers usually within the letter of the law and accounting Standards. Creative accounting practice employed by preparers of financial statements has created wide gap in the measurement and assessment of business income and performance due to the selfish interest of few stakeholders to the detriment of the larger society.

RECOMMENDATIONS

1. The need for collaborative effort among the professional accounting bodies, accounting training institutes, the government and the judiciary in the fight to curtail creative accounting practice among preparers of financial statements to save potential and prospective investors.

2. There is need for urgent review of some accounting standards that are exposed to loopholes which guarantee access to international misstatement by corporate management of financial results in order to mislead investors and other users of published financial report.

3. Cash flow should be used to access and measure entities performance because it is more reliable and more difficult to manipulate than statement of financial performance (profit or loss).

4. Audit committee should be liable material misstatement in order not erode investors' confidence.

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