

# CREATIVE ACCOUNTING PRACTICES AND ITS ASPHYXIATING IMPACT ON INCOME TAX COMPLIANCE BY FIRMS IN DELTA STATE

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## **Abstract**

The income statement presented by firms to Revenue departments is believed to be manipulated to gain tax advantages. This is called Creative Accounting. This study was carried out to determine the veracity of this claim and its asphyxiating impact on income tax generated by Revenue departments in Nigeria, taking Delta state as a case study. A survey design was adopted. From the large number of possible respondents, a sample of sixty respondents was randomly selected from Asaba, Warri and Agbor. A twenty item structured questionnaire drawn on a 5 point Likert type scale was administered and retrieved. The mean and standard deviation was used to analyse the data. The study revealed that most organizations engage in creative accounting for tax gains. This attitude affects Government revenue. It was recommended that revenue department have more to be more vigilant, train its staff regularly, and ensure that sanctions for Tax violations are strictly enforced.

One basic importance of keeping accounting records is to be able to generate information that will support good decision by all users. Wood and Sangster (2005) and Smith and Smith (2010), mentioned that financial statements should provide accurate information that can be used by interested parties to assess the performance of managers and the firm to make economic decisions. Accounting regulations provided by Accounting Standard Boards and professional bodies like ICAN and ANAN attempt to ensure that information is provided on a consistent basis in accordance with a set of rules that make users rely on them. Users therefore assume that the financial information they receive from organisations records are reliable and fit for decision making.

These users according to Wood, and Sangsters (2005), Amahi, and Uge (2004), include: management, shareholders and owners, potential investors, lenders, bankers, trade creditors and suppliers, analysts, Government (MDAs), Tax authorities and others whose activities and decisions may rely on the information presented in the organizations' financial statements.

To fit into the demands of their diverse users, Wood and Sangster (2005) in a thirty year survey (1975-2005) of financial reports observed that good reports contain information that are relevant, reliable, objective, easy to understand, comparable, realistic, consistent, timely, complete and properly presented. Striving towards the above ideals has also presented another dimension to the plight of businesses whose many user groups have different indices for determining the opinions they hold about the organizations. This results in many organizations preparing different sets of statements

for different users, so as to meet their users' needs for information and at the same time sustain existing or facilitate new relationships. Herein, lies the dilemma of business organizations.

Communication between business organizations and users Wrage and Vega (2007) opines, are as a result, exposed to distortions by the activities of managers and Accountants who may alter the message being transmitted. These distortions affect reported income which therefore provides no true reflection of the entity's position. This scenario is described by Merchant and Rockness (1994) as creative Accounting. They observed that many organizations report profits when they are not making profits; or depress it at will when they find it convenient to do so. Income declared then becomes a tool manipulated according to the circumstances or use to which they intend to put them. Niguette (2002) and Wrage and Vega (2007) observed in like manner that in some instances, organizations make information in financial statements look bad even though they are making profits, in order to avoid paying the right income tax. Activities of this sort Peter and Hudgins (2008) believe, work to conceal the true financial conditions of the firm involved; thus making financial decisions relying on them flawed. This attitude and activity of creative accounting is therefore an 'ill wind...' It is an abuse of power which misleads the users and weakens the authority of regulators leaving all stakeholders; including the firm itself hurt.

In Nigeria, creative accounting is now the rule, rather than the exception as all organizations are believed to be involved in these unethical practices at varying levels and capacities. There are claims by industry watchers and economic analysts that a huge proportion of the nations potential revenue from income tax are either not properly captured or are lost due to several reasons among which is poor disclosure or creative accounting. This study attempts to determine the veracity of this claims and the impact of such distortions.

### **Statement of the Problem**

Successive governments at State and Federal levels have been criticized on their inability to put in place appropriate and quality infrastructure and public goods to justify the revenue realized from taxes among others. However Government and its relevant agencies have continuously refuted these claims, explaining otherwise that they experience huge shortages and shortfalls in tax expectations which account for their continuous campaigns and sensitization on issues relating to taxes in the Nigerian media.

### **Purpose of the Study**

The purpose of this study is to determine the level of manipulations of profit statements by organizations managers (i.e., creative accounting) and its asphyxiating impact on income tax generated and proffer solutions to ensure that government is able to maximally generate revenue from Income tax.

### **Scope of the Study**

This study is carried out to determine the level of manipulations of firms profit statements (i.e., creative accounting) and its asphyxiating impact on income tax generated from firms in Delta State.

### **Research Questions**

The following research questions were formulated to guide the study:

1. What aspect of a firm's records is manipulated to gain tax advantage?
2. What are the impacts of creative accounting on firms, Government Revenue Departments and the society at large?

### **Methodology**

A survey design was adopted since the study involved eliciting information from a wide audience comprising, officers of Delta state revenue department, officers and managers of firms, Business Educators and interested publics. A sample of 60 respondents made up of 20 Economic analysts and Business Educators (from the Federal College of Education (Technical), Asaba, Colleges of Education Agbor and Warri), 20 officers of the Delta state revenue service and 30 Managers of firms was randomly selected from Asaba, Warri and Agbor. A 20 item structured questionnaire was drawn on a 5 point likert type scale and administered after necessary validation to elicit responses on the aspects of an organization's records susceptible to manipulation, and the impact of such manipulations on the firm, Revenue Department and the society. Data was analyzed using mean and standard derivation statistical tools.

### **Data Presentation and Analysis**

The data collected were analysed based on the research questions generated for this study using mean and standard derivation.

### **Research Question I**

What aspects of a company's profit statement are manipulated to gain tax advantage?

**Table I: Mean Rating and Standard Deviation of Components of Company Profit Statement Manipulated to Gain Tax Advantage**

S/N.	X	SD	Remarks
1. Transactions are not always backed by source Documents.	2.96	0.75	Disagree
2. Source documents are usually manipulated.	2.50	0.56	Disagree
3. Sales figures are understated.	2.87	0.73	Disagree
4. Purchase figures are overstated.	2.67	0.71	Disagree
5. Incomes are understated.	3.80	0.44	Agree
6. Incomes are deliberately omitted.	2.73	0.64	Disagree
7. Domestic expenses are absorbed in Revenue expenses.	3.77	0.43	Agree
8. Specific provisions for bad debts are overstated	3.90	0.66	Agree
9. Bad debt figures are overstated	3.90	0.66	Agree
10. Donations to approved bodies are overstated	2.06	1.37	Disagree
11. Losses on sales of fixed assets are included on normal losses.	3.40	0.81	Agree
12. Manipulations is aimed at reducing profit	3.96	0.41	Agree
<b>Grand Mean</b>	<b>3.21</b>		<b>Agree</b>

In the table above the grand mean of 3.21 was used as a basis of agreeing or otherwise whether any identified component of a company's profit statement is manipulated to gain tax advantage. It was observed that although items 1, 2, 3, 4, 6 and 10 are manipulated to gain tax advantage, the level of such manipulations are not significant. Other questionnaire items are accepted as being significantly manipulated for tax purposes.

### **Research Question 2**

What are the Impact of Creative Accounting on the firm, Revenue department and society?

**Table 2: Mean Rating and Standard Deviation of Impact of Creative Accounting on the Firm, Revenue Department and Society**

S/N.	X	SD	Remarks
Creative accounting:			
13. distorts a firms true position	4.70	0.65	Agree
14. affects the firms ability to obtain	4.53	0.73	Agree
15. affects the growth and image of the firm	4.10	0.71	Agree
16. demotivates workers whose efforts seem	3.43	0.73	Disagree
17. depresses the profit of a business and makes it look worse	4.10	0.84	Agree
18. reduces revenue from tax	4.80	0.48	Agree
19. weakens the authority of Regulating Bodies	3.13	0.63	Disagree
20. weakens Government ability to provide public goods.	3.63	0.67	Agree
<b>Grand Mean</b>	<b>4.05</b>		<b>Agree</b>

In the table above, the grand mean is 4.05 and is used as the basis of our decision. Items 13-16 focused on impact of manipulating components of the income statement on the business, 17-19 on Tax revenue and item20 on the impact on society. It was observed that apart from item 16 which scored low on the rating all others, items 13, 14 and 15 shows that the manipulations can significantly affect the business. The responses to items17 and 19 show that creative accounting can greatly affect the revenue of the tax department, However responses to items 19 and 20 do not agree that creative accounting has a significant effect on the powers of the tax regulating bodies and Government.

### **Discussion of Findings**

Creative Accounting is generally carried out to enable an organization gain some advantages in its relationship with various stake holders who are the users of income statements. To enjoy maximum advantage Wood and Sangster (2005) explains that a business concern may prepare different statements for use of it's different users. The major emphasis of this work centre on the level and impact of manipulation of Income statements carried out to gain tax advantage. A 20 Item Questionnaire was constructed. It's validity were confirmed by three members of association of Business Educators of Nigeria (ABEN) and lecturers in the Department of Business Education,

College of Education, Agbor before it was adopted for use. The items were intended to help find answers to the research questions formulated.

It was revealed that a high level of manipulations is carried out by organizations on the components of their income statements presented to the internal revenue departments for tax assessments. Major manipulations are carried out on the Income and revenue expenditure item in the profit statements. Incomes are understated and in some instances ignored or out rightly omitted. Domestic expenses and losses from sales of fixed assets are absorbed under other acceptable expense heads, specific provisions for bad debt and actual bad debt figures are overstated and a lot more.

However it reveals that organizations seem to maintain some level of ethical posture by not altering their source documents. Generally it reveals that organizations engage in creative accounting to gain tax advantage.

The impact of creative Accounting like all unethical behaviours according to Uge (2008) and Peter and Hudgins (2008) can be felt by all.-the government, tax authorities, the society and even the organization itself. It depresses profits, affects workers morale and portrays an organization worse than real. Affected organizations find it difficult to obtain loans for expansion and worse, short term credits for meeting working capital needs. It reduces income accruable to government through tax and weakens Government ability to provide relevant infrastructure for public use. Above all it misleads Government in its policy thrusts.

### **Conclusion**

Creative Accounting activities though geared towards meeting organizations needs are considered short termed by this researcher. It is wicked, fraudulent and deceiving. It is an 'ill wind' that leaves every one – users and the organization itself, ultimately hurt.

### **Recommendations**

The following recommendations are suggested:

1. Curriculum planners should accommodate Ethics as a teaching subject in schools so as to gradually build into learners the need for ethical considerations on every assignment.
2. Professional associations should provide a code of Ethics for their members and rigorously enforce planned sanctions against non compliance.
3. Accounting bodies like ICAN and ANAN should attempt to put in place a multipurpose and all serving method of financial reporting to control the possibility of manipulations.
4. The tax authorities should be more vigilant and proactive. They should embark on more training programmes for their staff. They should enforce all sanctions on tax violations to serve as deterrents to potential violators.

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