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EFFECT OF CREATIVE ACCOUNTING ON SHAREHOLDERS' WEALTH: A CASE OF COMPANIES LISTED ON RWANDA STOCK EXCHANGE

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Abstract: **Creative accounting involves the manipulation of company financial records towards a predetermined target. Creative accounting plays a significant role in financial reporting, but it has been negatively correlated that means more managers involved in it may decrease the value of financial information. The creative accounting practices are prevalent and attributed to bad corporate governance. Accountants apply strategies that enhance creative accounting by using profit eroding mechanisms which lead to drastic consequences. The objective of this research was to establish the effect of creative accounting practices on shareholders' wealth of companies listed at Rwanda stock Exchange. The objectives of the study were: to determine the effect of income smoothing on shareholders' wealth of companies listed at the RSE, to examine the effect of accelerated depreciation on shareholders' wealth of companies listed at the RSE and to determine the effect of tax avoidance on shareholders' wealth of companies listed at the RSE. This research adopted a mixed research design which is a combination of descriptive design, causal design and cross-sectional design. The target populations comprised of top management of public limited companies that is the CEO, directors, top managers and accountants. A sample of 32 individuals was drawn from the public companies at RSSE using purposive sampling. Census approach was adopted in this study. A multiple linear regression technique was used to analyze the relationship between creative accounting practices and shareholders wealth. Quantitative approach through the use of questionnaires was adopted to help in the collection of primary data for analysis purposes. The secondary data was collected from RSE handbook relevant text books, finance journals, financial statements and the website of public limited companies that were sampled. Data was analyzed for descriptive and inferential statistics using SPSS version 21. Descriptive statistics such as tables, graphs, charts and percentages analysis were used for presentation of data. The data findings analyzed also showed that taking all other independent variables at zero, a unit increase in tax avoidance will lead to a 1.32 increase in Shareholders wealth; a unit increase in income smoothing will lead to a 0.81 decrease in Shareholders wealth, a unit increase in accelerated depreciation will lead to a 1.83 increase in Shareholders wealth. This infers that accelerated depreciation contribute more to Shareholders wealth of firms listed at the RSE followed by tax avoidance. At 5% level of significance and 95% level of confidence, tax avoidance had a 0.03 level of significance; income smoothing showed a 0.022 level of significant, accelerated depreciation showed a 0.000 level of significant hence the most significant factor is accelerated depreciation. The study recommends that local investors should embrace shareholder value concept as an excellent model for value creation to increase insider trading meant to boost investor confidence and sense of security as guaranteed by mutual interests in growth in shareholder value. Further research should be carried out on other employees who could be involved in creative accounting therefore indirectly affecting shareholders wealth.**

Keywords: **Income smoothing, Shareholders' wealth, Rwanda Stock Exchange.**

1. INTRODUCTION

1.1 Background

Globally, for users of financial report to make economic decisions, financial reports must provide useful information (Ezeani, Ogbonna & Ezemoyih, 2012). This information can only be useful if it fulfills basic qualitative characteristics of financial statements (Amat & Gowthorpe, 2010). The International Accounting Standard Board (IASB, 2009) Framework emphasizes that relevant financial information should be predictive or confirmatory in nature. This should be such that the financial information of a specific entity was considered material when its omission influences economic decision of its users.

Sawabe (2009) emphasized the innovative aspects of creating accounting in maneuvering accounting numbers and argued that innovation is an essential part of creative accounting practices involved in innovative accounting practices. The managers are entrusted to take care and grow the shareholders' wealth. Salome, (2012), explains that information asymmetry creates agency conflict between management and shareholders as explained the agency theory. Accountants, who are stewards of shareholders, collaborate with directors in manipulating accounting figures rather than showing a true and fair view of financial accounts.A need therefore arises to identify creative accounting practices, how they are practiced, as well as looking at the effect they have on shareholders' wealth.

According to Gherai and Balaciu(2011), the anticipations of a company becoming reality, a great need to generate trust with an accurate image reinforces a feeling that such a company practicing transparency is safe. The freedom of decisions allowed by most accounting regulatory bodies are characterized by inadequacy of accounting regulations, their heterogeneity and the evolving process of harmonization encourage an increase in creative accounting practices. They also emphasized that creative accounting and fraud are practiced when enterprises face financial difficulties and are motivated by the desire to deceive. These practices disappeared only with the fading of their primary causes.

Simser (2008) elucidates that taxpayers are required to pay taxes based on accounting and legal advice provided which should be aligned to the firm's financial reports and the existing tax rules. Taxation is complex and exploring the tax system requires the guidance of skilled lawyers, accountants and other advisors. Tax evasion is unacceptable and/or illegal while tax avoidance is perfectly acceptable however there is no clear line between the two. This is the dilemma that is faced by the advisors. Tax evasion is perpetrated through acts such as presenting incorrect statement of accounts, making false entries or alterations, or false books or records, destruction of books or records, concealment of assets or covering up sources of income constitute tax evasion (Malkawi, and Haloush, 2008).

Studies carried out internationally and locally indicate the existence of creative accounting in companies. Ozkaya,(2014) studied creative accounting practices in the Turkish government specifically in the public sector. These practices manifested in hidden debts affecting IMF's stabilization programme forecasts. Odia and Ogiedu(2013) stated that in Nigeria the creative accounting practices are prevalent and attributed to bad corporate governance. Salome, (2012) studied strategies used by accountants in Nigeria to practice creative accounting and found out that they use profit eroding mechanisms which lead to drastic consequences like corporate scandals and collapse both international and locally as in the case of WorldCom and Enron. In Kenya, there are companies that over-report their Shareholders wealth to meet targets and please ever demanding shareholders. This highlights the existence of creative accounting. According to Kamau et al., (2012), this trend has now more than ever ensures that financial statements are sternly scrutinized. Kotter (2008), discovered robust association between the variables (creative accounting and Shareholders wealth) among listed companies in Kenya. Most companies use creative accounting practices abusively.

Assihet al., (2013), States that earnings management means modifying of financial disclosures with the motive of private gain done through involvement in the process of external financial reporting. It takes the form of smoothing of earnings, antagonistic smoothing of incomes and distortion of financials. Shah, (2011) further explained creative accounting as the intentional influence exerted on financial reported figures to suit the impression of managers to stakeholders by a view other than the actual performance or financial position of the company by applying accounting knowledge and discretion within the jurisdiction of laws set up by accounting regulatory bodies.

Practices of creative accounting has facilitated many companies beyond financial crises than put them into crisis. The fault when it emerges lies with the user of the financial information. A study carried in India by Shah *et al.*, (2011) clearly showed how creative accounting was used to by companies producing cement during financial crises in the country. Many companies used the creative accounting techniques to remain afloat. Companies showed profits or minimized losses by change of depreciation policy when demand and production of cement was low. This kept investors reasonably comforted and staff relaxed by paying out dividends out of the profits. Shareholders' wealth was increased as per the reported profits. Even when demand and production increased they did not change the accounting policy.

With increasing hard economic times, companies may be motivated to practice creative accounting for diverse reasons. Players in the accounting profession may not fully understand the operations of creative accounting because different companies practice creative accounting for different reasons. Carrying out research on the influence of creative accounting practices on shareholders wealth of public limited companies in Rwanda helped the players in accounting profession to empirically understand the implications of such practices on shareholders wealth of firms in Rwanda. It is upon this backdrop that the study intends to find out whether such practices as tax avoidance, accelerated depreciation, and income smoothing as part of the major creative accounting practices have an influence on the shareholders wealth of companies listed at Rwanda stock Exchange. This study established the effect of creative accounting practices on shareholders' wealth of companies listed at the Rwanda Stock Exchange in Rwanda.

1.2 Statement of the Problem

Of recent years, researchers have debated about creative accounting which is widely used to describe accepted accounting techniques which permit corporations to report financial results that may not accurately portray the substance of their business activities. Preparers of financial statements are in a position to manipulate the view of economic reality presented in those statements to interested parties. However, an emerging stream of literature, which examines tax avoidance in an agency framework, suggests that opportunistic managers employ the technologies of tax avoidance to advance managerial, rather than shareholder, interests (Desai & Dharmapala, 2009)

Regulators of accounting profession in Rwanda seem to be silent on the issue of creative accounting yet it is widely practiced among many companies in the country (Mauwa, 2016). Further users of accounting information seem not to have perceived this practice of creative accounting which has led to collapse of many major companies globally such as Enron and world com (Ayala & Giancarlo, 2009) and locally such as Dyer and Blair (Bonyop, 2009). An example is Uchumi supermarkets ltd which is listed in Rwanda stock Exchange that admitted in the financial statements for 2015 that creative accounting was being practiced up to the year 2014 when new management took over (Mire, 2015).

As much as there are many studies that have attempted to unravel the problem of creative accounting a study by Joshi & Li (2016) who argued that most of the business enterprise have been linked with fraudulent activities as well as largely affected by financial collapses. On analysis, it is noted that most of the standards that are being set for the audit or accounting have been eroded. Some of the famous accounting scandals such as Enron, Parmalat, World Com and Tyco where these scandals have cost billions of dollars and even damaged the accounting profession that result in financial misstated figures.

To explain the concept in detail, it is understood that the current business environment as well as more economic recession recently had pushed the top management authority of most of the organization to pay attention on how to make the financial statements of their company so that it look better and able to attract the investors (Yadav, Kumar & Bhatia, 2014). By using creative accounting practices, the company manipulates figures in their financial statements either they increase or decrease the numbers and it entirely depends upon what the company need to achieve at that particular point of time. Fraud nowadays had become one of the major threats for business organizations (Del Brio, Lopes-e-Silva & Perote, 2016). Fraud is treated as big risk that incurs a very big cost that results in several other problems where stakeholders lose confidence and interest. In addition, the researcher finds out the issues and makes an effort to come with a solution to financial statement fraud. Furthermore, the particular research work will focus upon involvement of auditor in solving creative accounting problems. Therefore, the researcher tries to focus upon corporate government and uses as a tool that will help in fraud detection as well as prevention at the same time (Ozuomba, Anichebe & Okoye, 2016).

To fill the identified research, gap this study was carried out to assist the shareholders and other stakeholders by investigating the effect of creative accounting on the shareholders' wealth before making decisions with regard to potential and current investments in companies listed at Rwanda Stock Exchange.

1.3 Objectives of the study

1.3.1 General objective

The general objective of this study was to establish the effect of creative accounting on shareholders' wealth of companies listed at the Rwanda Stock Exchange in Rwanda.

1.3.2 Specific objectives

The specific objectives were:

1. To determine the effect of income smoothing on shareholders' wealth of companies listed at the Rwanda Stock Exchange in Rwanda.

2. CONCEPTUAL FRAMEWORK

Independent variables		Dependent variable
Income smoothing • Delaying sales • Increasing R&D expenditures • Overstating asset write-offs	→	**Shareholders wealth** • Stock prices • Earnings per share • Dividends payouts

Figure 2.1 Conceptual framework

2.1 Research gap

Studies on creative accounting have gained momentum over the recent years. Studies have been done on creative accounting in public sector, for example Melo, Pereira and Souza (2014) researched on why some governments resort to creative accounting. Reischmann (2015) also studied creative accounting and electoral motives based on the public sector. Vyas, Ambadkar, and Bhargavaf (2015) carried out their research on truth and fairness of financial statements in relation to creative accounting based on the private sector. The study by Tassadaq and Malik (2015) was also based on the corporate world. These studies mainly dealt with existence, techniques and consequences of creative accounting in various countries. This study was based on private sector and carried out a comprehensive analysis of the management practices influencing creative accounting using a multiple regression model approach.

The review of literature suggests that there are researches that have been carried out mostly from United Kingdom, USA (Vermeer et al., 2014), Malaysia (Abuaddous et al., 2014), Iran, India (Bhasin, 2015), Nigeria (Sanusi &Izedomni, 2014), among other studies. Not much of the studies have been carried out on the effect of creative accounting from a Rwanda's perspective. This study contributed towards filling the knowledge gap by establish the effect of creative accounting practices on shareholders' wealth of companies listed at the Rwanda Stock Exchange in Rwanda.

3. TARGET POPULATION

Target population in statistics is the specific population about which information is desired. According to Ngechu (2014), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. This definition ensures that the population of interest is homogeneous. And by population the researcher means the complete census of the sampling frames. According to Mugenda & Mugenda (2008), target population in statistics is the specific population about which information is desired. The target population for this study were the firms listed at Rwanda Stock Exchange (RSE) as at the year 2017. By the end of the year 2017, there are8 firms listed at the Rwanda stock exchange. The target population was 32 employees of the 8 firms. These employees included the company managers, accountants, internal auditors, and floor managers at the offices of each of the selected listed companies at Rwanda Stock Exchange. A census approach was applied since the population is too few

4. RESEARCH FINDINGS AND DISCUSSION

4.1 Income Smoothing on shareholders wealth'

The first objective of the study was to determine the effect of income smoothing on shareholders' wealth of companies listed at the Rwanda Stock Exchange in Rwanda. The findings are presented under the following sub headings.

4.1.1 Dividend payout policy to shareholders out of profits

Respondents were requested to indicate what is the dividend payout policy to shareholders out of profits.

Table 4.1: Dividend payout policy to shareholders out of profits

	Frequency	Percentage
Constant payout policy	4	13.3
Stable dividend policy	20	66.7
Residual dividend policy	6	20.0
Total	**30**	**100.0**

The study findings indicated that 66.7% of the sampled respondents agreed that their organizations use stable dividend policy when distributing their profits to shareholders with 13.3% and 20% revealing that their organizations use constant payout policy and residual dividend policy respectively.

4.1.2 Duration of payout policy

Respondents were requested to indicate how often dividend payout policy to shareholders out of profits. Their views were noted as shown in Table 4.2

Table 4.2: Duration of Dividend payout policy

	Frequency	Percentage
Very often	15	50.0
Often	9	30.0
Rarely	6	20.0
Total	**30**	**100.0**

From the sampled respondents 20% revealed that their organizations rarely change their dividend payout policy while 30% of the respondents agreed that their organizations often and 50% very often change their dividend payout policy.

4.1.3 Duration considered to change the dividend payout policy

Respondents were requested to indicate duration considered to change the dividend payout policy.

Table 4.3: Duration considered to change the dividend payout policy

	Frequency	Percentage
2-3 years	0	0
3-5 years	9	30.0
6-8 years	6	20.0
9-10 years	15	50.0
Total	**30**	**100.0**

The findings indicated that 30% of the sampled participants in this study revealed that between 3 years and 5 years their organizations do change their dividend payout policy while 50% revealed that their organizations do change their dividend policy between 9 years and 10 years.

4.1.4 Respondents views on income smoothing

The study sought the view of the respondents in regard to income smoothing. Respondents' opinion on income smoothing with regard to shareholders wealth was captured using 1-Strongly disagree; 2 – Disagree; 3 – Indifferent; 4 – Agree; 5 – Strongly agree. The statements, respondents' opinions and their percentages are as shown below:

Table 4.4: Income smoothing parameters

	Mean	Std. Dev.
Your organization truly attain a steady growth in profits	4.14	.744
Your organization is able to sale off an asset and lease it back again to increase profits	3.56	.685
A risk averse manager who cannot access capital markets has the incentive of income smoothing to improve firm value	3.26	.770
Management always engage in delaying and pre-invoicing sales to attain their set targets	3.89	.572
Your organizations transfer transactions from period to period to manage profitability of the firm	3.45	.791
Management may classify some operating cash flows under investing or financing activities	3.58	.748
Your organizations recognize revenues while the sale transaction is still incomplete	4.18	.748

According to the findings in Table 4.4, majority of respondents disagree that always organizations truly attain a steady growth in profits represented with a mean of 4.14 thus a reflection of the same in shareholders wealth could be misleading. Majority of respondents also agreed that the organization is able to sale off an asset and lease it back again to increase profits, this was represented by a mean of 3.56. Also, the study found out that majority of respondents perceived that a risk averse manager who cannot access capital markets has the incentive of income smoothing to improve firm value by agreeing as indicated by mean of 3.26. Also, majority of respondents agreed that management always engage in delaying and pre-invoicing sales to attain their set targets as indicated by mean of 3.89. The study also sought to find out whether organizations transfer transactions from period to period to manage profitability of the firm and majority of respondents agreed as indicated by mean of 3.45. The study also found out that majority of respondents agreed that management may classify some operating cash flows under investing or financing activities as indicated by mean of 3.58. Finally, the study sought to find out whether organizations recognize revenues while the sale transaction is still incomplete, and majority of the respondents disagreed as indicated by mean of 4.18.

This is similar to a study conducted by Graham, Harvey, and Rajgopal (2015) indicates that most CFOs believe that earnings are the key metric considered by outsiders, and seventy-eight percent of the 400 executives in their sample would rather sacrifice the long-term value to smooth reported earnings. When the manager of a firm has the option to choose the time when income is recognized, he or she may prefer the accounting measurement and reporting rules that are expected to result in more smoothed income streams. Recent empirical work by Rountree, Weston, and Allayannis (2008) suggests that earnings volatility decreases firm value.

5. CONCLUSIONS

The study also concludes that most firms engage in smoothing of incomes rather than reporting volatile profits. The study also concurs with conclusions made by other researchers who found a negative relationship between earnings volatility and firm value find evidence that when a firm current shareholders wealth is poor relative to expected future performance, managers tend to smooth income by increasing accruals, i.e., borrow future earnings for use in the current period.

5.1. Recommendations

Based on the findings of this study, the researcher proposes the following recommendations:

There should also proper internal systems to curb the vice of income smoothing among the management of firms which transforms to poor Shareholders wealth or collapse of most companies. Income smoothing should be hedged since the practice does not give a true reflection of firm’s shareholders wealth.

The researcher also recommends management should use cost recovery methods such as accelerated depreciation effectively to manage firms better since the findings shows that mismanagement of cash flows has been the norm

5.2. Areas for further research

Further research on the effects of creative accounting on the growth of Rwanda’s economy may also be critical in extending this research. This is because creative accounting just like any concept has its advantages and disadvantages. However there seems to be more negative effects than the benefits of creative accounting.

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