



An enquiry into false declaration of profits by Nigerian oil companies as a corporate governance tactic

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Abstract

This paper attempts a socio-economic and legal enquiry into the prevalence of the doctoring of accounting records of oil companies in Nigeria filled with many incidences of insider trading, manipulative and unethical boardroom practices, inflation of stocks and false declaration of profits to save face and trick unwary investors into becoming shareholders of an unprofitable business venture. It found that the practice is not alien to the oil sector and that the primary motive behind same was to feign success and achieve utmost corporate profitability through the backdoor. It equally found that creative accounting was a short-term corporate governance instrument with no systemic structure for corporate performance and sustainability.

Keywords: enquiry, Nigeria, company, oil and gas, profits, corporate performance

Introduction

The incidence of untruthfulness and lack of transparency in corporate affairs is not a new one. Companies through their Directors have severally been found to engage in insider-trading and other kind of abuses and unethical conducts in order to achieve corporate objectives and maximise profits at all costs. In fact, it was reported by Premium Times News Magazine on the 24th day of October, 2017 that a Nigerian Oil firm, Oando Plc allegedly declared dividends from unrealised profits and equally released fake and falsified financial records to the public. The consequence of this unethical act was that the company got suspended by the NSE, the Nigerian Stock Exchange whilst it conveyed the suspension vide a correspondence to Oando by SEC, the Securities and Exchange Commission. This is just a classic example of how companies can a false declaration of profits, assets and liabilities to deceive unsuspecting investors and claiming that expediency is the mother of invention- labelling it creative accounting largely deemed an important strategy for effective corporate administration in the Nigerian oil industry. Thus, in order to deter a financial system that is being vulnerable to volatility and manipulation, effective corporate governance mechanisms, such as good regulatory structures and efficient supervision, must be enforced throughout the financial markets in the oil and gas companies. These three pillars must also be in effect for a well-functioning company: sustainable procedures, accurate accounting and reliable reporting. Using innovative tactics to re-ignite consumers' curiosity in his stagnant client base is like attempting to revive a pork roast after you've tossed it in the garbage (Ayo 2019)^[5]. Especially as an unclear or a falsified accounting structure is likely to be a weak governance system (Giroux, 2006). While the oil sector is best thought of as a private company, it must be noted that it is deeply institutionalized to the point that a special kind of interpretation of corporate governance is needed in order to better restrain the actions of management.

When money is looked at as an intangible thing, it may be registered as this or it may be seen in a deceptive way and exchanged for money. "The concept of declaring losses as profit is any financial activity that has little short-term advantage to the company but which can in the long term prove to be harmful to its profitability and survival", Merchant and Rockness claim in a recent study (Presswire, 2019). This could generate a challenge for the oil company, as well as create chances of unfair competition. This might then equally lead to a disturbance in the whole administration or encourage inflationary trends and market destabilization.

This research then submits that an important corporate governance framework that accommodates the administration of such companies in the nation without the allure of deception is needed for sustainable growth and development on one hand and that accounting deceit cannot be a sustainable corporate governance strategy. This would consist of the structure, measures, processes, and practices including good board representation, increased resource use, and accountability.

Significance of the Study

This study is significant in many respect. It will raise the awareness of critical stakeholders most especially unsuspecting shareholders and investors on the ills of false profits declaration and reveal the mode of operation of unethical conducts of Directors and accountants in the administration and running of their business concerns.

It will also assist Government regulatory agencies in their quest to block revenue leakages, detect the activities of corporate bodies shortchanging them by filing in fictitious tax returns and add to the avalanche of literature contribution on the subject of creative accounting and corporate governance especially in oil companies in Nigeria and beyond.

The Rationale for False Declaration of Records in the Corporate Governance of Oil Companies

OECD- the Organization for Economic Co-operation and Growth, (2014), stipulates firmly stating the statutory roles, powers and duties of shareholders and the directors should be contained in the overarching position of the corporate governance system devoid of deception. It also stresses the significance of transparency, corporate integrity and accountability's efficacy. Furthermore, it notes that a company should exist within the culture rather than the society as a whole. Although it is difficult to develop a strategy that suits both conditions and economies, the International Finance Corporation (IFC) (2004) suggests that corporate governance should be oriented towards good results as a good rule of thumb that is devoid of lies, financial opaqueness, deceit, falsification of accounting records and mindless misrepresentation. This position will look at how the governance of corporate bodies and processes are employed in the elimination of agency costs in Nigerian oil production firms.

Shareholder voting, forming boards of directors, and filling board seats in a way that protects the needs of all stakeholders is something that can be maximized. An internal economic index or an external economic index may be used to determine the extent of corporate governance within a business organization, just as declaring a large profit in place of monumental loss can affect the fortunes of an oil company on the long run. Concerns would however arise in terms of existing mechanisms within the companies when it comes to internal management systems. Interference from outside the company's sphere dictates the external structure in terms of external processes. The EC believes that many internal control mechanisms, such as the audit committee, board composition, CEO duality, oversight, among others, are capable of lowering operational costs. Close to this is the refusal to declare full profits in order to avoid the company's tax obligations to the government. Apart from the economic implication of false declaration of profits, it has a criminal consequence. In fact according to the laws governing Company fraud and money laundering, (Companies Income Tax Act), non-declaration of the funds or false declaration is an offence punishable upon conviction by the individual or company also forfeiting the funds or the financial advantage obtained by the reason of such deceit. By the combined provisions of Sections 9 and 13, a resident company is liable to tax on its worldwide income being its profits accruing in, derived from, brought into and received in Nigeria. A non-resident company is equally liable to tax on its income derived from Nigeria that is- those attributable to its Nigerian operation. It is hereby noted that whether an oil company would be governed by the general provisions of the Companies Income Tax Act or the Petroleum Profits Tax Act would be very much predicated on whether the company was into winning of oil operations strictly speaking and thus making profits thereby.

According to a research conducted by (Owolabi S.A 2010) ^[47], Out of the top One hundred companies in Nigeria he examined, out of the first Twenty, Fourteen are from the banking industry, many of which showed the wanton declaration of fictitious profit. He considered the typology of valuation of properties, fraudulent use of information and false declaration of financial position as some of the fraudulent practices common in the Nigerian polity.

A General Recount of Nigeria's Oil and Gas Industry

Oil was discovered in Oloibiri, now part of Bayelsa province, and later in Rivers state, Nigeria. Nigeria is home to

over 190 million people and a plethora of human and natural resources, especially crude oil. (Ayo 2019) ^[5]. Nigeria is the third largest oil producer in Africa, the tenth in the world and the most prolific in Sub-Saharan Africa, according to the 2017 Nation's Fact Book. Nigeria's economy is mostly reliant on hydrocarbon exploration which provides almost half of the country's foreign revenue generation. The economy of Nigeria has been labelled a one phase-economy owing to its near-total reliance on oil sales for survival. Nigeria has a vibrant offshore oil industry that is the country's sustenance pipe and the cornerstone of its trading and financial activity. The offshore oil industry is the single most important sector of the Nigerian polity. The offshore oil sector is the most important economic market in Nigeria, accounting for more than 90% of all exports. In accordance to the 2012 BP Statistical Energy Survey, Nigeria had proven oil reserves of 37.2 billion barrels at the end of 2011, equivalent to 41.4 years of existing production and 2.25 percent of global reserves. The nation produced about 2457.3 thousand barrels of crude oil a day in 2011, accounting for 2.93 percent of global product. Her proven oil reserves are estimated to be over 35.2 billion barrels. (Department of Petroleum Resources, 2019 Oil Reserve Estimate). Established reserves are forecast to reach 45 billion barrels by 2021. The verified natural gas estimate of Nigeria are billed to be around 176 trillion cubic feet (Tcf). However, since she lacks a working gas infrastructure, she flares approximately 75% of her associated gas and just re-injects the remaining 12%. The nation set a goal of zero flaring of gas by 2020, which was not met as well as providing incentives for gas production and use. Natural gas exports are expected to account for half of the government's total revenue by 2021. (Source: US Department of Energy).

Oil revenues dominate Nigeria's foreign exchange earnings, accounting for almost half of the country's earnings. Current daily supply is normally limited by OPEC quota reductions. Nigeria's oil production falls in reaction to OPEC's response to global oil supply as a member of the cartel.

The bulk of the oil is explored in the oil basin of the Niger Delta. About its perennial challenges with ethnic conflict, boundary tensions and support from government, the nation's oil riches make it a very appealing tourism and wealth multiplication hotspot for oil companies, the majority of which have flourishing businesses in Nigeria, with Shell overseeing the concession contract's current Joint Venture Agreement.

With four refineries operating with a combined capacity of 438,750 barrels per day, her downstream oil industry is also significant. Fires, deliberate vandalism, insufficient management, absence of a turn-around maintenance, and pervasive corruption have all hindered the refineries' ability to function at even 40% of its entire capacity. As a result, there are refined oil shortages and a desire to raise imports in order to satisfy the home energy market needs. Similarly, the nation's petrochemicals sector is fast expanding, due to the country's large refining potential and ample natural gas reserves. The petrochemical industry in Nigeria is centred in three cities: Kaduna, Warri, and Eleme. As a result, processed commodities are still in short supply and imports are often used to satisfy domestic demand. Oil importers always pay more than the agreed-upon controlled pump price, prompting the Nigerian government to subsidize the products. Nigeria's petrochemicals industry is booming, due to the country's huge refining capacity and plentiful natural gas reserves.

Generally, the Nigerian National Petroleum Corporation (NNPC), a 100% state-owned oil company, dominates the entire Nigerian oil industry through its holding of shares in all of the country's companies, where it is saddled with the responsibility of equally determining market prices. But until 1960, the government's role in the oil sector was constrained to monitoring and administering monetary policy. In 1971, Nigeria joined OPEC, and the Nigerian National Oil Corporation, (NNOC), later renamed the Nigerian National Petroleum Corporation, NNPC, was created in accordance with OPEC resolutions. This vast parastatal supervises, controls and monitors all facets of the oil sector, (downstream and upstream), through its Directorate, the Department of Petroleum Resources, while the Ministry of Petroleum Resources is in charge of regulating the Nigerian petroleum sector through its Directorate, the Department of Petroleum Resources (DPR).

As far back as year 2000, the government of Nigeria had formed an oil and gas committee reform to oversee NNPC's privatization and deregulation strides. Nigerian Petroleum Production Company- oil marketing agency, Eleme Petrochemicals Company Ltd and Hyson Nigeria Ltd which was not fully owned were three of the seven NNPC subsidiaries expected to be sold. Nigeria's former Petroleum and Natural Resources Minister, Mrs Diezani Alison Madueke, was the organization's Secretary-General as a valuable member of the Organization of Petroleum Exporting Countries (OPEC)- to demonstrate the country's vantage position as an oil resource bed in the world. The NNPC's sector and activities are tightly regulated by the government, whose senior executives are chosen by the governing party. Oil is collected in Nigeria's 7 sedimentary basins: the Niger Delta, the Benue Trough Anambra, Benin and Chad. The Niger Delta, Shallow Offshore and Onshore basins have also been exploited thoroughly. There are an estimated 606 oil fields, the bulk of which have estimates that are not less than 100 million oil barrels. Oil fields are still well-known on the periphery. The basins are home to around 80% of all Nigerian producing wells, making them low-risk investments. Exploration became high-risk investments in deep-water offshore basins in the late 1990s, with positive returns for developers. Oil prospecting and mining prospects are becoming more attractive as deep-water drilling and developments advance. (Department of Petroleum Resources, Historical Background).

According to the Mbendi African Fact file, Nigerian crude oil is considered to be among the finest, with an API gravity ranging from 21 to 45 points. The two most important export crude oil are Bonny Light (37 percent) and Forcados (31 percent). Around 65 percent of the oil from Nigeria has an API of 35 or higher and has a low sulphur quality. Nigeria has a quota of over 1.89 million barrels per day (bbl/d) with OPEC. There are around 176 oil-related businesses in Nigeria, with 62 of them being Petroleum and Exploration companies.

According to the Nigerian Bureaucratic fact book, Nigeria also has a variety of administrative entities that are operated by the government as indicated earlier. Nigeria's downstream oil sector is also a significant contributor to the country's economy. In the country, there are 8 oil companies, 4 oil refineries and over 750 independent agents who are engaged in petroleum products' sale. Smuggling across borders is a chronic problem, and large-scale corruption in the delivery and marketing chains is often documented. The government has had all-encompassing

influence over the industry through the NNPC, Nigerian National Petroleum Corporation (NNPC), which holds shares of all of the firms concerned and sets wholesale and retail prices.

The three key types of threats associated with investment in Nigeria's oil sector are internal violence and civil war, government's unstable economic policies and party boundary disputes. Apart from these, there is also the challenge of ongoing monumental graft, particularly prominent in the oil industry. It is therefore not surprising that the oil and gas sector would suffer economic crunches due to systemic failure, necessitating the rescue of creative accounting and false declaration of profits deployed by the conniving machinations of oil company Directors, their Auditors and Accountants.

Contextualizing False Profits Declaration as a Corporate Governance Strategy.

As critics analyze the conceptual aspect of falsified records giving an untrue picture of the company's financial fortune as a corporate governance tool, they often discover a significant third theme: knowledge asymmetry between companies and stakeholders. As a consequence, for the former to survive, the two must maintain their relationship. The present literature's analytical analysis looks into how those who guard the gate are themselves deserving of some measure of controls, checks and balances, faced with the critical mission of removing intelligence asymmetry. Among them are financial analysts, institutional lenders (the majority of whom are block shareholders), auditors, directors, company monitors, pressmen and their committees on audit, credit bureaus and investment bankers. The aim of corporate governance tool is to significantly eliminate information asymmetry and ensure that financial reports are in accordance with best accounting practices while the financial records of the company remain correct, "uncooked," and "undoctored." As officers, trustees, and privies of the funds of shareholders, corporate directors and business managers have a responsibility to ensure that financial statements and documentation are in line with appropriate accounting practices while the company's financial accounts remain accurate, true, unfalsified, "uncooked," and "undoctored." There is a substantial drawback and justifiable expectation placed on company directors to run the company well or do their best in the best interests of the providers of the capital used to run the company and therefore set sustainable corporate objectives of real time profits as a result of improved business strategies that is devoid of unprofessional deceitful practices, professional company administration and insist on sure-footed corporate sanity.

Aside from experience asymmetry, there are several issues that arise in all or every organizational scenario when it comes to corporate governance and creative accounting. Rather than focusing on sustainable economic growth, directors and accountants usually focus on quick-paced selfish agenda and short-term benefits geared towards increasing the stock market value of the shares of the company for shareholders, declaring dividends as a reflection of presumed profitability and the desire to clandestinely increase more income-focused compensation for the company's board, for example, so as to receive bonuses or achieve more corporate emolument. The Directors use a range of manipulative strategies to attain the short-term objective of presenting an optimistic picture of corporate success to customers and the public, which is at the core of creative accounting and has

since risen to the forefront of study as an aspect of the corporate governance process. Dechow, *et al.* (2006) shared some of their initial thoughts based on observational observations that showed a strong and substantial correlation existing between the incidence of managing earnings and the absence of successful corporate governance structures. The following features were identified: absence of a working committee on audit; CEO/Chairman duality and mix of office and board functions; absence of an independent auditor to put a restrictive review on the activities of the board of directors and management excesses and corporate recklessness; and insider dealings due to insider oversight of the corporate board of directors. After that, further studies followed up and confirmed their point of view.

Falsification of Accounting Position and Profits in Nigeria

False Declaration of Profits is seen in almost every sector of the economy and is visible all around the globe. Global oil companies' accounts in Nigeria showed evidence of dishonest accounting procedures (Izeze 2008). Izeze alleged that estimates of oil deals and declaration of profits from all transactions statutorily delivered to the DPR, Department of Petroleum Resources and the NNPC, Nigerian National Petroleum Corporation and even the Federal Inland Revenue Service, FIRS for their attention as part of legislative regulatory obligations were mostly cooked up and that oil multinationals in Nigeria have practiced imaginative accounting for a long time, unintentionally fleecing the country of its vast wealth—they also reduced the worth of the country's vast fortunes.

In a similar vein, after the company's failed privatization in 2001, the Board of Directors of African Petroleum Plc (AP) falsified their accounting records in order to conceal a huge 23 billion Naira debt. Proshare, 2019. (Source: Proshare, 2019). It was about the pivotal *locus classicus* case that opened the eye of the public on inventive accounting in the Nigerian oil industry that an analysis of the 'made up' records of AP, African Petroleum Plc, which was set for a public offer in 2001, became public knowledge. Thanks to the Directors' actions, the Auditors were almost successful in concealing the company's unenviable finances in order to present it as a viable going concern. The company's previous stock-market meltdown was triggered by this action. False Declaration of Profits and indeed the financial position is all too simple, manipulative and unwanted. Mata, *et al* (1999) contended that apart from African Petroleum Plc, Nigerian commercial banks worked with oil companies to give out loans directly to stockbrokers in order to buy their own shares so as to sustain demand pressure, resulting in a significant rise in the price of the shares without an equal increase in the attendant values of the purchased shares, resulting in a continuous rise in share price without a corresponding increase in the values of the purchased shares. They were therefore painting an untrue picture of the value of their shares for pecuniary advantage. (Oluba 2009 and Ayo 2019) ^[5].

Stockholders have been shown in some surveys to be unable to see past the financial illusion provided by deceptive accounting. According to (Healy and Wahlen 2019), investors cannot see beyond manipulative presentation of accounts and creative accounting before the advent of equity issues has a huge effect on share prices. Signalling has been reported to be commonly misinterpreted or ignored even by comparatively advanced users. Taffler and Breton (Breton and Taffler, 2005). Dechow and

Skinner (2000) found that some investors were unable to process information contained in the financial statement notes. Consumers would be unable to cope with and explore innovative accounting, they concluded, even though financial statements contain sufficient detail to that end, comprehending same remains an issue to the average shareholder. This view was questioned by (Dharan and Lev 1993), who discovered that income accounting changes were related to poor share price performance in the years studied. In a functional and performing market, market operators would not be misled by dressed-up, aesthetic accounting dressing costs, according to analysts (Amat, Blake, and Dowds 1999). Directors will also use imaginative accounting to reduce access to the release of valuable information to the public, raising the odds of profiting from insider information when engaged in insider dealing and trading abuse, they added. As a result, creative accounting has been a part of corporate accounting since the dawn of time.

Falsification of record scandals are often the source of stock market tremors and customer distrust. Shareholders' fears that the recession would spread to other large oil, banking and telecommunications firms were validated as the crisis spread to other major energy, banking, and telecommunications corporations. The stock prices of the country's major oil companies dropped by more than 33% between 2000 and 2004, while technology stocks fell by 70%. Interestingly, more than over seven hundred companies had to re-list their earnings over the past five years, sarcastically acknowledging that they had equally dabbled in imaginative accounting. Accounting errors cost the top 500 companies almost a fifth of their net earnings between 1997 and 2000, according to (Lindstrom 2009; Ajayi 2019). Academics have been debating the concept of false declaration of profit for quite some time. Through considering it from an ethical perspective, many recent literature found it to be unethical, and therefore frowned upon it as a very untoward and unacceptable accounting practice (Gowthorpe and Amat 2005). They argued that this kind of dishonest accounting is devoid of fairness, equality, morality and respect for the rule of law, which they believe are social minimum acceptable for determining evidence. They also separated dishonest conduct into two categories: a) macro manipulation, which involves forcing regulators to issue beneficial enabling policies based on available doctored accounts in the form of Goodwill accounting, and b) micro manipulation, which involves manipulating accounting data to create a biased perspective at the enterprise level. On the other hand, both forms were frowned upon as religiously repulsive colours of fraudulent accounting. Proof of imaginative accounting practice has been found all around the world (Sen and Inanga 2005; Ajayi 2019). Izeze (2008), for example, found signs of innovative accounting in the Nigerian oil industry's books. According to Conner (1986) in the ageless study he carried out, imaginative accounting can easily mislead and misleading advertising because it instils a false, yet believable facade that the company to which the falsified accounting records relate is performing well and successful, when in fact it is not. (Sen and Inanga (2005); Ayo and Ajayi (2005)) (2019) ^[5].

Motive for False Declaration of Profits by Nigerian Oil Companies

False declaration of profits is used for a variety of reasons, including covering up theft, dishonest misrepresentation for a

fictional over-bloated share price transaction, lure unsuspecting investors, avoid tax obligations, circumvent ownership transition, etc. Accounts are often times cooked up to meet the needs of a peculiar group of auditors and accountants. According to Schiff (1993), members of the public who are investing should be very cautious in the taking a company's financial statements for it because they might just as well be buying a lie and billed to lose their investment. He claimed that the EPS, earnings per share or the amount paid by investors when they spend their money, could easily be increased. Counting own sub-company's profits and net worth as separate acquisition, cutting down on obligations, capitalizing costs in lieu of paying them down and concealing underlying pension obligations are just a few of the options available. According to a survey conducted with over 1,400 Australian Accountants conducted by Leung and Cooper (1995-2018), innovative accounting is a more difficult and widespread accounting challenge than the evasion of tax. (Merchant and Rockness 1994) conducted their own study into the motivations for cooking up accounts and discovered that false declaration of accounting statements motivated by strong self-interest and conflict of interest received more criticism than creative accounting motivated by furthering the company's cause. It is frequently 'forgiven' if the motivation was a business goal rather than the offender's own self-interest, but then whatever action that achieves corporate profitability at the expense of the general public's gullibility remains an unethical act. Similarly, accountants are typically tougher on accounting code violations than on transaction manipulation, thus, when accounts are falsified to achieve corporate performance, the management cover up the fraud and part the perpetrators at the back, as long as such falsification does not unduly enrich them at the expense of the company's corporate fortune.

Conclusion

In conclusion, it is restated that most often time than not, those who should frown at and mostly punish perpetrators of false declaration of profits are most times the prime beneficiaries, close collaborators and the mind and will behind such insidious official action. Similarly, in order to keep the wheels of corporate governance spinning, those in charge (Directors) participate in different ways of insider dealing and through the hands of the accountants engage in the falsification of the company's accounting records by wilfully declaring false profits to solve some material exigencies. As a result, many of these oil companies, especially in Nigeria, used the false declaration of profits to manipulate and avoid regulatory checks by either reducing profits to mitigate tax burdens or claiming exaggerated profits to entice unsuspecting potential shareholders to buy the company's shares at an inflated value. As a consequence, in an effort to solve one problem, they create more problems in its wake. It is hereby recommended that ethical conduct, organizational transparency, accountability and probity be inculcated as an integral policy architecture for corporate governance in Nigeria's oil industry, the inculcation of false declaration of profits to evade the correct payment of tax and lure unwary investors should be thoroughly discouraged. Finally, the concept of separation of powers must be adopted to corporate governance and false declaration of profits must be severely discouraged as a corporate governance strategy if sustainability

of operations, deception and misrepresentation would not arise in company administration.

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