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Insights on Financial Statement Fraud and its Implications on the Financial Performance of Selected Manufacturing Industries in Nigeria: An In-Depth Study of Cadbury Nigeria Plc.

Ijeoma Perpetua, Onuoha Ph.D.

Accountancy Department,
Alex Ekwueme Federal University, Ndufu Alike, Nigeria.
onuohaijeomaperpetua5@gmail.com
+2347033548086

Abstract

Research Purpose: Amidst rising concerns about corporate integrity, this study investigates the impact of financial statement fraud on the financial performance of manufacturing industries in Nigeria, using Cadbury Nigeria Plc. as a case study. Understanding these fraudulent activities is critical for improving corporate governance and financial transparency.

Methodology: The study analysed secondary data from Cadbury Nigeria Plc's financial records spanning 2004 to 2023. Trend analysis was employed to detect significant changes in financial performance due to fraud, focusing on incorrect asset recognition and improper expense recognition.

Findings: The analysis reveals that financial statement fraud, driven by both internal and external factors, significantly undermines the company's financial performance. Fraudulent practices distort the financial health of the company, misleading shareholders, creditors, and regulatory authorities.

Conclusion: The study concludes that financial statement fraud has detrimental effects on the financial performance of manufacturing companies. Effective corporate governance is essential to mitigate these risks and ensure accurate financial reporting.

Recommendations: Businesses should implement robust monitoring and control mechanisms to detect and prevent financial statement fraud. Strengthening corporate governance practices is crucial to safeguarding the interests of shareholders and maintaining financial transparency.

Key words: *Financial Statement Fraud, Incorrect Asset Valuation, Asset Valuation Fraud, Business combination fraud, Biological Assets.*

1.0 INTRODUCTION

Businesses and firms are always under the risk of fraud from different sources, one of which is that which emanates from financial statements. There are several kinds of frauds of which the highest is financial statements which this study focuses on. This kind of fraud which is mostly termed corporate fraud, has been asserted to be the number one threat to business organisations and its impact and how it has destroyed reputable companies and firms can be traced to the collapse of corporations such as Oceanic Bank, WorldCom, Enron, Lehman Brothers etc. However, this kind of fraud is mostly one with the approval or knowledge from insiders directly or indirectly. It involves intentionally misrepresenting financial information in order to deceive stakeholders such as investors, creditors or regulators. The effect and damage financial statement fraud has on an organisation, cannot fully be accounted for ranging from the reputational damage, financial damage, decline in market value of the firm, decreased investor confidence, increased regulatory scrutiny, lower credit ratings, loss of business relationships and so on. The negative impact of financial statements cannot be overemphasised, most of these companies who experience this kind of fraud, hardly recover from the damage in terms of overall performance and long-term viability and it may sometimes lead to the closure of such companies.

Unfortunately, these fraudulent acts have led to failure in corporate governance as well as embracing the negative effect of creative accounting. With the use of creative accounting, company's financial statements portray a positive image thereby deceiving the shareholders, creditors, regulatory authorities and other users of accounting information.

Companies over time have adopted several governance structures to curb the issue of financial statement fraud, however, there have been prevalent cases of financial statement misappropriation, misrepresentation, auditing gaps. This has made the issue of financial statement fraud a very important and extensive topic giving the collateral long term damage it causes on the overall performance of firms. This is why this study focuses on the impact of financial statement fraud on the overall performance of selected manufacturing industries with emphasis on Cadbury Nigeria Plc.

1.1 Statement of the Problem

Financial statement fraud is a prevalent issue that affects organisations across different sectors and countries. The problem addressed in this study is the impact of financial statement fraud on the financial performance of selected manufacturing industries. Understanding the impact of financial statement fraud on the performance of manufacturing industries is very important not only to the organisation, but to investors, regulators and other stakeholders as it helps make informed decisions. It is believed that when financial statement fraud happens in any organisation, it is mostly as a result of some factors which include; poor corporate governance and structures, unsuccessful board administration and staff mismanagement, impact of firm heads, directors, CEOs and MDs. Amongst a lot of issues faced with financial statement fraud, such as loss of trust of shareholders, creditors and other users of accounting information on the company, increase in the operating cost of the organisation, high rate of money laundering activities which will adversely affect the society at large and also cause a diminishing effect on the asset of the company.

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Additionally, Rezaee (2002) provides the following assessment of the problems that firms that conduct financial statement frauds are most likely to encounter: It jeopardises the accuracy and reliability of the financial reporting process, the objectivity and integrity of the accounting profession, the confidence of capital markets and market participants in the validity of financial information, the efficiency of the capital market, the growth and prosperity of a country, and it may lead to litigation losses. It obliterates the careers of those complicit in the fraud; it promotes further regulatory action; it results in bankruptcy or financial losses for the firm that committed the fraud; and it undermines the regular operations and performance of the accused companies.

Despite the growing awareness of this issue, there is little or no research that looks at the impact of financial statement fraud on the performance of manufacturing industries, particularly in Nigeria. As a result, this study aims to contribute to the body of knowledge by looking at the extent of financial statement fraud and how it affects the performance of selected manufacturing industries in Nigeria by looking at the financial statements of Cadbury Nigeria Limited over a specific time period.

1.3 Objectives of the Study

The main objective of this study is to identify the impact of financial statement fraud on selected manufacturing industries in Nigeria, a study of Cadbury Nigeria Plc. While the specific objectives are as follows:

1. To examine the effect of incorrect asset valuation on profit after tax (PAT) of selected manufacturing industries in Nigeria.
2. To analyse the effect of improper expenses recognition on profit after tax (PAT) of selected manufacturing industries in Nigeria.

1.4 Research Questions

1. To what extent does incorrect asset valuation affect profit after tax (PAT) of selected manufacturing industries in Nigeria?

2. To what extent does improper expense recognition affect profit after tax (PAT) of selected manufacturing industries in Nigeria?

1.5 Research Hypothesis

The research hypothesis which will be adopted in this study will be null form:

Ho1: Incorrect asset valuation has no significant effect on profit after tax (PAT) of selected manufacturing industries in Nigeria.

Ho2: Improper expense recognition has no significant effect on profit after tax (PAT) of selected manufacturing industries in Nigeria.

2.0 REVIEW OF RELATED LITERATURE

2.1 Empirical Literature Review

Oduanyo (2014) did research on fraudulent financial reporting: The Nigerian Experience Investigation potential prevalence of false financial statements with the registered firms in Nigeria in the United Kingdom. The research looked at 212 businesses that were registered in 2007. The study discovered a connection between inadequate internal control mechanisms and financial fraud communication. The author suggests strengthening the internal control mechanism.

Ikpefan (2006) performed research on the rise in financial scams and their impact on the financial industry. The results of the study revealed that financial scams have been on the rise recently, rising by 350 percent from 3399.39 billion in 1994 to 8,309.83 billion in 2004. According to the report, financial institutions have consistently engaged in financial fraud because they have failed to implement the essential controls and regulations in all facets of bank operations. The research consequently advised management of financial institutions to strengthen their internal operational methods by recruiting specialists, as this will increase the public's trust in the sector's operations.

Olaoye and Dada (2014) looked at the fraud analysis in Banks: Nigeria Experience. It explicitly investigates the economic environment, causes, repercussions, methods of discovery and preventative actions for financial fraud. The authors came to the conclusion that, while it is important to reward individuals who show high levels of integrity and avoid financial scams, it is also important to decrease the frequency of firing financial employees. The research suggested that people who are implicated in fraud should always face punishment.

Nenyiaba and Okoye (2015) found a substantial association between accounting standards, corporate governance, and internal controls in determining how free financial statements are from fraud in Nigeria. The study was conducted in the banking sub sector and the public service. It also revealed that the independence of auditors, whistleblowing, and the degree of accountants' education received little to no attention.

3.0 METHODOLOGY

3.1 Research Design

The research methodology is the systematic approach used by researchers to collect and analyse data for a study. This chapter presents the research methodology used to investigate the effect of financial statement fraud on the financial performance of Cadbury Nigeria Plc. The study adopted *Ex- Post Facto* research design. This has to do with the use of already existing data. This method of research design also examines how the independent variables affect the dependent variables. The variables under this study are categorised into dependent variables (financial performance) and a set of independent variables (incorrect asset valuation, improper asset recognition) which are in line with the research objectives and the chosen estimation model. The study adopted this design because of the nature of the research which requires the use of past or historical data. Also, a single-method research design was adopted.

This approach allows for the use of quantitative research methods to gather and analyse data. The financial data will be analysed using financial ratios such as profitability ratios, liquidity ratios, leverage ratios, and activity ratios. The study focused on the financial performance of Cadbury Nigeria Plc. for the period of 2004 to 2023.

3.2. Sources of Data

This study makes use of quantitative data which was generated from secondary data sources. The quantitative method will involve the use of secondary data obtained from the annual financial reports of Cadbury Nigeria Plc. The financial statements were obtained from the Nigerian Stock Exchange and the company's website. The financial statements used for this study include the income statement, balance sheet, and cash flow statement. The data collected covered a period of three years, from 2004 to 2023. The data obtained was validated by cross-checking the data with other financial reports and statements released by the company.

3.3 Model Specification

The model for the research variables was specified as follows;

Y =f(x)…………………………………………………... (1)

Where:

Y is the dependent variable (financial performance) which was proxied as profit after tax (PAT) of the selected manufacturing industry.

X is the independent variables which are incorrect asset valuation (INAV), improper expense recognition (IMEV) and board failure (BF).

More specifically, equation 1 can be written in a non-stochastic form as follows:

PAT = f (INAV, IMER, BF) ……………………………………………………2

Where;

PAT is Profit after Tax,

INAV is Incorrect Asset Valuation,

IMER is Improper Expense Recognition,

BF is Board Failure.

Therefore, we can rewrite equation (2) in its stochastic explicit form based on the functional relation as follows:

$PAT= b_0 + b_1 INAV+ b_2 IMER + b_3 BF + \mu_1$... (3)

Where;

All variables are as previously defined,

b_0 is the regression constants,

b_1, b_2, b_3 are the parameter coefficients, and

μ_1 is the stochastic error term.

Transforming equation (3) into a natural logarithm, we have

$$\text{InPAT} = b_0 + b_1\,\text{InINAV} + b_2\,\text{IMER} + b_3\,\text{BF} + \mu_1 \ldots\ldots\ldots\ldots (4)$$

Thus, the transformed log linear equation using the ordinary least square (OLS) method of regression analysis. The use of the log linear method improves the validity of the estimates. This method also reduces the heteroscedasticity errors which may result from unsealed magnitude on both sides of the equation.

3.4 Description of Model Variables

In this research project, quantitative variables are used. These variables are divided into explanatory and dependent variables.

Dependent variable

- **Financial performance:** Financial performance is the measure of an organisation's level of financial health over time (Aizan 2016). Profit after tax was used in the calculation to approximate profitability.

Independent Variable

- **Financial statement fraud**: This deliberate falsification of claimed financial results is done to conceal the organisation's financial situation. The following variables are used to measure this variable.
- **Incorrect asset valuation**: This is when a corporation exaggerates its assets and presents them in a more favourable financial light. Improper valuation of inventories, investments (such as securities or other investments without a ready market for sale, such as sparsely traded shares), non-current assets, or accounts receivable are all examples of this (Surenraj 2013).
- **Improper expense recognition:** When costs for a business are not properly recognized or reported at the same period as the corresponding revenue, this occurs. This research looked at issues such inventory values that were artificially inflated and audit failure. Provision of past-due bills and sluggish inventory, Provision for terminal gratuity, Provision for payments to governmental authorities and regulators Inappropriate deferral of spending and incorrect reporting of margin on earlier years' sales are both reflected.
- **Board Failure:** The example of board failure given here completely accounts for the role played by internal elements in the development of financial statement fraud. Financial statement fraud is said to be caused by a number of causes, including weak corporate governance and organisational structures, ineffective board management,

employee mismanagement, and the influence of business executives, directors, CEOs, and MDs.

3.7 Method of Data Analysis

This study adopted the use of statistical tools in carrying out the work. The hypothesis was formulated in a null form and was tested statistically. The collected data was analysed using trend and ratio analysis. Trend analysis was used to compare the financial data over a period of time. It helps to identify patterns and trends in financial statements and provides insights into the performance of the organisation over time. Ratio analysis was used to identify, analyse and interpret the lapses in this financial statement of Cadbury Nig. This study also carried out a descriptive statistical approach. Descriptive statistics is a statistical technique used to organise, summarise and present data in a meaningful format.

4.0 PRESENTATION AND DATA ANALYSIS

4.1 Introduction

Table 1: Trend Analysis of Cadbury Nigeria Plc. (2004-2023)

Financial Performance	2017 to 2023	2010 to 2016	2004 to 2009
Total Revenue	199,215,152	299,454,185	222,152,651
Profit After Tax	(44,665,459)	22,710,921	22,812,623
Net Cash Flow	(133,576,661)	22,267,926	6,322,784
Shareholders' funds	22,186,795	100,868,170	99,459,727
Basic Earnings per shares	(4288)	2700	2811
Adjusted Earning Per shares	(4244)	2466	-
Dividend per shares	-	1300	1600

Source: Cadbury Nig. Plc. Consolidated Financial Report

From the trend analysis, there was a significant decrease in the company's total revenue, net profit after tax, and shareholders' equity from 2004 to 2023, which is attributed to the material misstatement of N14.6 billion inherent in the company's financial statement as adjusted in 2023. The company's cash flow deteriorated aggressively with a total negative net cash flow of -N13.5 billion as at 2023 accounting year end. Thus, that shows that over the years, the company has not been financially liquid to meet up their short-term obligations which may have led to inappropriate deferment of expenditures over the years to the tune of N1.2 billion. Shareholders' funds dropped to N2.1 billion as against an opening balance of N10.8 billion.

4.2.2 Ratio Analysis

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Ratio analysis was used to determine the company's financial performance from 2004 to 2023. The analysis involved calculating key financial ratios such as profitability ratios, liquidity ratios, and solvency ratios. The results of the ratio analysis are presented in Table 2.

Table 2: Ratio Analysis of Cadbury Nigeria Plc. (2005-2023)

Financial Ratios	2017 to 2023	2010 to 2016	2004 to 2009
Gross Profit Margin	36.7%	38.1	39.3%
Net Profit Margin	-24.3%	9.2%	12.7%
Current Ratio	0.61:1	1.7:1	1.4:1
Quick Ratio	0.33:1	1.31:1	0.88:1
Debt-to-Equity	11.8%	46%	-
Interest Cover	-2.2 times	4.5 times	6.64 times
Earnings Per Shares	-N0.428 Kobo	N0.270 Kobo	N0.281 kobo
Inventory turnover	206 days	107days	149 days

Cadbury's financial statements from 2004 to 2023 were collected from various sources, including the company's annual reports, SEC filings, and financial statements. The financial statements were analysed using various financial ratios and metrics to evaluate the company's financial performance over the years.

The following financial ratios were used to analyse Cadbury's financial performance:

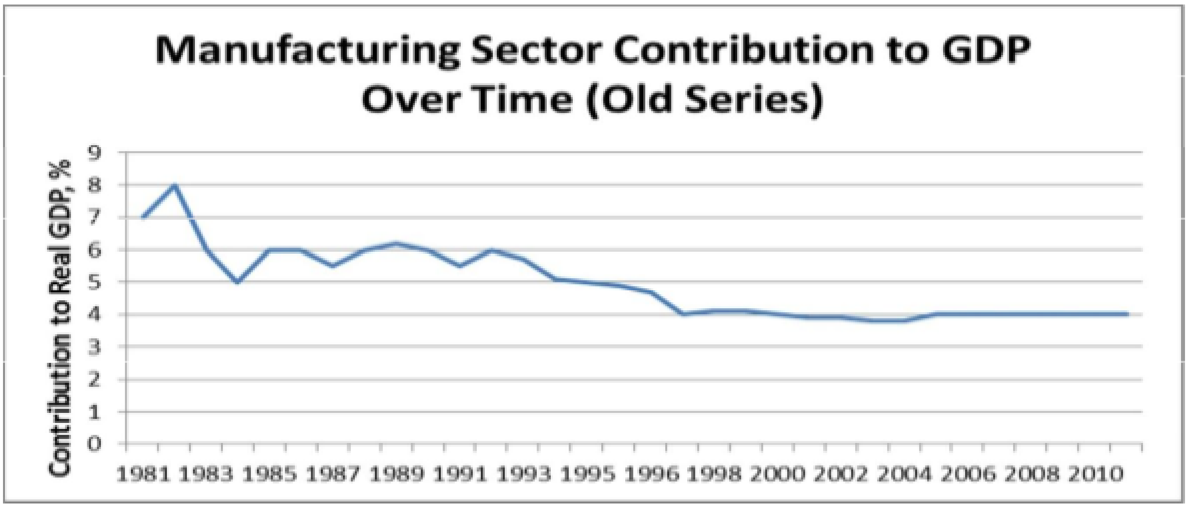
Liquidity Ratios: These ratios measure the company's ability to meet its short-term obligations. The current ratio and quick ratio were used.

Profitability Ratios: These ratios measure the company's ability to generate profits. The gross profit margin, net profit margin, return on assets, and return on equity were employed in this case.

Solvency Ratios: These ratios measure the company's ability to meet its long-term obligations. We used the debt-to-equity ratio and interest coverage ratio.

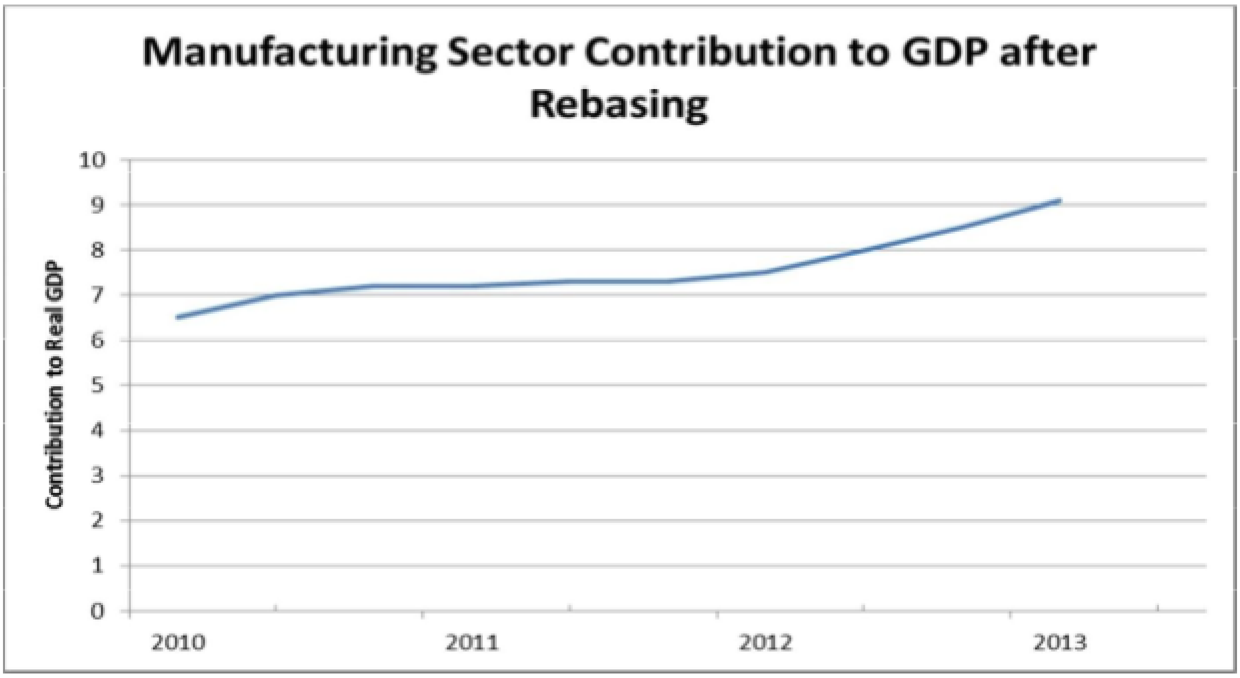
The financial ratios were compared across years to identify any significant changes or trends that could be attributed to financial statement fraud.

Figure 1: Manufacturing Sector Contribution to Real GDP over Time



Source: Nigeria Bureau of Statistics.

Figure 2: Manufacturing Sector Contribution to GDP after Rebasing



Source: Nigerian Bureau of Statistics

4.3. Findings

Cadbury Nig. Plc. financial statements showed significant manipulation and misrepresentation, making it challenging to obtain accurate financial ratios. However, significant changes and trends that indicated financial statement fraud were identified.

From 2004 to 2010, Cadbury Nig. Plc. liquidity ratios remained stable, with a current ratio ranging from 1.4 to 1.7 and a quick ratio ranging from 0.88 to 1.31. However, in 2013 to 2023, the company's liquidity ratios deteriorated significantly, with the current ratio dropping

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to 0.61 and the quick ratio dropping to 0.31. This indicated that the company was having difficulty meeting its short-term obligations, and it was relying heavily on short-term borrowing to finance its operations.

Cadbury Nig. Plc. profitability ratios also showed significant changes and trends that indicated financial statement fraud. From 2004 to 2023, the company's gross profit margin ranged from 39.3% to 38.1%, while the net profit margin ranged from 12.7% to 9.2%. However, in 2023, the company's gross profit margin decreased to 36.7%, while the net profit margin decreased to -24.3%. This significant decrease in profitability was not consistent with the company's operations and was likely the result of fraudulent activities.

Cadbury's solvency ratios also showed significant changes and trends that indicated financial statement fraud. From 2004 to 2023, the company's debt-to-equity ratio ranged from 0 to 46%, while the interest coverage ratio ranged from 6.6 to 4.5. However, in 2023, the company's debt-to-equity ratio decreased geometrically to 11.8, indicating that the company's high proportion of their debt was converted to ordinary shares, thus leading to dilution of control. Additionally, the interest coverage ratio dropped to 0.5, indicating that the company was unable to cover its interest expenses with its earnings.

From 2004 to 2023, Cadbury's investor ratios remained stable with a slide decrease of 11kobo. However, in 2023, the company experienced a drastic fall of their earnings per share to 428 Kobo and this unfavourable event is attributed to the material misstatement in which; when all necessary adjustment was made, affected the profit made in 2023.

In the years 2023, the company's loss increases with #1,678,727,000 this was as a result of damaged and expired inventories in their warehouse. Based on this, there was absolutely poor inventory and production management and sequel to the working capital efficiency ratio, finished products stayed in the warehouse for an average period of 207 days before being sold. Thus, production is above demand compared to 2004 and 2023.

4.4 Discussion of Findings:

Sequel to the review on Cadbury Nig. Plc. Consolidated Financial statements for the year ended 2004 to 2022 financial statements, the material statement of N14.6 billion has been in existence over three years prior to 2006. This error was discovered and adjusted in 2006 in line with the Nigeria Accounting Standard. This unfortunate event affected the performance of the organisation which led to loss of Shareholders Funds and public trust. Based on discoveries as captured from note 23 of the audited consolidated financial statement of the company, the accounting errors emanated from the following items.

		N'000
1.	Recognition of artificial values in inventories	2,822,819
2.	Provision of long overdue debts and slow-moving inventories	2,701,165
3.	Provisions for terminal gratuities	2,293,719

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4.	Provisions for payments to Govt. Authorities and Regulators	1,884,118
5.	Incorrect recognition of margin on sales in prior years	1,484,030
6.	Impairments to inventory items	1,258,958
7.	Inappropriate deferment of expenditure	1,237,239
8.	Impairments to other asset	880,883
9.	Impairment of investment in subsidiaries	-
10.	ICLS Dividend Paid	130,000
	Total	14,695,932

Furthermore, it was observed that responsible parties failed to play their role adequately, starting from the board of directors, External Auditor (AWD), and the SEC. Below are highlights of their misconduct and professional negligence exhibited by the responsible parties.

- **Board Failure**

It is clear that the board and top management of Cadbury Nig. Plc., allowed self-interest and sheer greed to come between them and their prime duty of shareholder value creation. It is on record, for example, that the company maintained and operated an undocumented and undisclosed off-shore account from which the previous managing director of the company, its former Finance director and other while executive directors were paid offshore remunerations. This was done without the approval of the committee responsible for fixing remunerations of Executive Directors and was not recorded, either, in the company's financial report and accounts. Thus the board embarked on what, with the benefit of hindsight, can be described as the destruction of shareholder value.

4.5 The Cadbury Scandal as a Case of Audit Failure

Audit failure or performance gap occurs when public expectations are reasonable but the auditor's performance does not fulfil them. This means that there is a shortfall in the auditor's performance. Many factors have been adduced as responsible for the increasing spate of audit failures in Nigeria. These include:

- Ethical Failure

- Negligence in carrying out the audit process

- Environmental and cultural influences and

- The limitations of the modern audit process (Chukwunedum 2009) the external auditors of the company, Akintola Williams Deloitte (AWD) , had been the external auditors of the company for over 40 years.

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

The study examined financial statement fraud and the financial performance of selected manufacturing industries, study- Cadbury Nigeria PLC. The research made use of secondary data which were sourced from the financial statements of Cadbury Nigeria Plc. for the years 2004 to 2022. In order to analyse the objectives of the study, trend analysis was used to identify any significant changes in the company's financial performance over the years. The analysis involved comparing the financial statements from 2004 to 2023 to determine any significant increases or decreases in the company's financial performance.

Improper asset valuation, improper expense recognition and board failure and others, were used to proxy the independent variables that could affect the performance of the firm in terms of the profit after tax which proxied the dependent variable financial performance. The study reveals that there was a significant decrease in the company's total revenue, net profit after tax, and shareholders' equity from 2004 to 2022 which is attributed to the material misstatement of N14.6 billion inherent in the company’s financial statement as adjusted in 2006. The company’s cash flow deteriorated aggressively with a total negative net cash flow of -N13.5 billion as at 2022 accounting year end. From 2004 to 2022, Cadbury Nig. Plc., liquidity ratios remained stable, with a current ratio ranging from 1.4 to 1.7 and a quick ratio ranging from 0.88 to 1.31. However, in 2006, the company's liquidity ratios deteriorated significantly, with the current ratio dropping to 0.61 and the quick ratio dropping to 0.31. This indicated that the company was having difficulty meeting its short-term obligations, and it was relying heavily on short-term borrowing to finance its operations. Cadbury Nig. Plc., profitability ratios also showed significant changes and trends that indicated financial statement fraud. From 2004 to 2023, the company's gross profit margin ranged from 39.3% to 38.1%, while the net profit margin ranged from 12.7% to 9.2%. However, in 2006, the company's gross profit margin decreased to 36.7%, while the net profit margin decreased to -24.3%. This significant decrease in profitability was not consistent with the company's operations and was likely the result of fraudulent activities

5.2 Conclusion

The Cadbury scandal is a clear example of the devastating consequences of financial statement fraud. The fraudulent activities at Cadbury led to the loss of Shareholder’s funds, and trust the loss of thousands of jobs, and significant financial losses for investors and other stakeholders. The analysis of Cadbury's financial statements showed significant changes and trends that indicated financial statement fraud. The result of this is still being felt and the company is still paying for this impact even after years have gone by.

The conclusions are based on the findings and analysis of the study. In all, the result shows the devastating impact financial statement fraud resulting from internal and external factors can have on any firm. This implies that companies and firms should be wary of this impact and tread carefully and ensure that measures are put in place to monitor and control financial statement fraud.

5.3 Recommendations

The negative impact of financial statement fraud on productivity cannot be overemphasized. Companies who have experienced this pay the price for a long time. Based on the result from this analysis, the following are recommended

1. All firms should adopt strategies and apply appropriate financial rules and regulations when preparing financial statements
2. Rapt attention should be placed on board members and staff who might be used to perpetrate financial statement fraud and adequate punishment be ensued on those found wanting
3. Members and staff of every firm should be educated properly on the short and long run damage financial statement fraud can cause to any firm
4. Internal audit group of any organisation, should be independent, with clearly defined functions and staff and other members of the board should have limited access to the audit committee
5. Accounting professional bodies and regulators should ensure proper management systems to check financial statement misrepresentation in organisations.

5.4 Suggestion for Further Study

This study suggests that further research should be carried out on the dangers of financial statement fraud on the productivity of firms especially in Nigeria. Many companies intentionally misrepresent the financial statements in order to deceive investors and other stakeholders without knowing the dangers that would befall the company in the long run. Therefore, it is essential that more study be carried out to help organisations make informed decisions by comparing other variables that can also influence financial statement fraud not only in manufacturing firms. Studies should equally investigate regulatory agencies and bodies who help in perpetrating financial statement fraud and how they can be sanctioned.

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