



BOARD INDEPENDENCE, CREATIVE ACCOUNTING PRACTICES AND FINANCIAL DISTRESS IN NIGERIAN LISTED DEPOSIT MONEY BANKS

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Abstract

The recurrent episodes of distress that have characterised the Nigerian banking industry have consistently been traced to weak internal oversight and the opportunistic exercise of accounting discretion by bank management. This study examined the effect of board independence and creative accounting practices on financial distress among Nigerian listed deposit money banks. Anchored on Agency Theory and Positive Accounting Theory, the study adopted an ex post facto research design and a positivist research philosophy, relying on secondary data extracted from the audited annual reports of eleven purposively sampled deposit money banks listed on the Nigerian Exchange Group over the period 2015 to 2024, yielding a balanced panel of 110 bank-year observations. Financial distress was proxied by the Ohlson O-Score, board independence was measured as the proportion of non-executive directors to total board size, and creative accounting practices were proxied by discretionary loan loss provisions (DLLP) obtained as residuals from a fixed-effects provisioning regression. Bank size, return on assets, and leverage were included as control variables. The Hausman specification test favoured the fixed-effects estimator over the random-effects alternative, and all models were estimated with cluster-robust standard errors to address cross-sectional dependence identified through Pesaran's test. The results showed that board independence had a positive but statistically insignificant effect on financial distress ($\beta = 0.7822$, $p = 0.691$), while creative accounting practices, proxied by discretionary loan loss provisions, also exerted a positive but statistically insignificant effect on financial distress ($\beta = 0.8595$, $p = 0.821$). Both null hypotheses were therefore not rejected. Leverage and bank size, however, emerged as consistently significant determinants of financial distress across both models. The study concludes that, within a tightly regulated banking environment such as Nigeria's, internal governance and accounting discretion do not independently drive distress outcomes, as regulatory and prudential controls appear to substitute for internal monitoring mechanisms. The study recommends that regulators move beyond numerical compliance with board-independence thresholds toward assessing the substantive competence and engagement of non-executive directors, while sustaining prudential oversight of loan-loss provisioning practices under the IFRS 9 expected credit loss framework.

Keywords: Board Independence; Creative Accounting Practices; Discretionary Loan Loss Provisions; Financial Distress; Deposit Money Banks; Nigeria.

Introduction

A sound and resilient banking system is central to the efficient allocation of financial resources, the preservation of

investor confidence, and the maintenance of macroeconomic stability (World Bank, 2020; CBN, 2023). Yet, recurrent episodes of banking distress across both advanced and emerging

economies continue to expose the vulnerability of the sector, a vulnerability that is frequently traced to weak corporate governance, excessive risk-taking, and the manipulation of financial statements. The global financial crisis of 2007–2009 offered a vivid illustration of how off-balance-sheet financing, complex derivative structures, and aggressive earnings management can obscure the true risk exposure of financial institutions (Leuz & Wysocki, 2016). In Nigeria, the 2009 banking crisis similarly revealed how institutions such as Oceanic Bank and Intercontinental Bank engaged in earnings manipulation, under-provisioned for non-performing loans, and concealed insider-related credits, thereby eroding investor confidence and threatening the stability of the entire financial system (Sanusi, 2010; Uwuigbe et al., 2015).

Corporate governance mechanisms, particularly the independence of the board of directors, are theoretically expected to constrain managerial opportunism and safeguard the integrity of financial reporting (Al-Homaidi et al., 2021). Independent, non-executive directors are presumed to be free from the conflicts of interest that often compromise the objectivity of executive management, and are therefore expected to provide effective oversight of financial reporting choices, including the exercise of discretion in loan loss provisioning (Hermalin & Weisbach, 2003). However, evidence from the Nigerian context suggests that board independence may sometimes exist more in form than in substance, owing to political connections, insider domination, and weak enforcement of governance codes (Adegbite, 2015; Okolie & Uwuigbe, 2021).

Alongside governance weaknesses, creative accounting, often described as earnings management, remains a persistent

concern in Nigerian banking. It refers to the use of the flexibility inherent in accounting standards to portray a more favourable financial position than economic reality warrants (Stolowy & Breton, 2004; Amat & Gowthorpe, 2010). Within banks, this discretion is most visible in the treatment of loan loss provisions, where managers may understate or overstate provisions to smooth earnings, meet regulatory capital targets, or conceal deteriorating asset quality (Ozili, 2020). While such practices may not always amount to outright fraud, their cumulative effect can delay the recognition of underlying financial weaknesses and, in principle, heighten the risk of eventual distress (Ahn & Gam, 2024).

Despite the theoretical linkages among board independence, creative accounting, and financial distress, relatively few Nigerian studies have jointly examined whether independent boards actually restrain the discretionary use of loan loss provisions in a manner that forestalls distress, or whether both governance and accounting discretion exert measurable and independent effects on distress outcomes once regulatory and macro-financial controls are accounted for. This article addresses that gap by empirically examining the direct effects of board independence and creative accounting practices on financial distress among Nigerian listed deposit money banks.

Statement of the Problem

The Nigerian banking sector has continued to experience recurrent episodes of financial fragility despite successive waves of regulatory reform, from the 2005 consolidation exercise to the establishment of the Asset Management Corporation of Nigeria (AMCON) following the 2009 crisis (Sanusi, 2010). More recently, persistent signals of distress, including rising non-performing loans and intermittent regulatory sanctions, point to continuing

weaknesses in governance and financial reporting practices.

Corporate governance structures such as board independence are theoretically expected to limit managerial discretion and curtail the practice of creative accounting (Al-Homaidi et al., 2021). In the Nigerian context, however, these mechanisms often fail to perform their intended monitoring role owing to insider domination, concentrated ownership, and weak regulatory enforcement (Olayemi & Olaleye, 2022). At the same time, empirical evidence on whether discretionary loan loss provisioning, as a proxy for creative accounting, translates directly into observable financial distress remains inconclusive, with some studies reporting a significant link (Akenbor & Ibanichuka, 2012; Wilson-Oshilim et al., 2024) and others suggesting that regulatory controls mute this relationship (Kanagaretnam et al., 2010; Alali & Jaggi, 2010). This lack of consensus, combined with the paucity of Nigeria-specific evidence covering the post-IFRS 9 era, constitutes the empirical problem that this study addresses.

Objectives of the Study

The broad objective of this study is to examine the effect of board independence and creative accounting practices on financial distress in Nigerian listed deposit money banks. Specifically, the study seeks to:

- i. Analyze the influence of board independence on the level of financial distress in Nigerian listed deposit money banks.
- ii. Examine the relationship between creative accounting practices and financial distress in Nigerian listed deposit money banks.

Research Questions

- i. What is the effect of board

independence on financial distress among Nigerian listed deposit money banks?

- ii. To what extent do creative accounting practices influence financial distress among Nigerian listed deposit money banks?

Significance of the Study

The findings are relevant to several categories of stakeholders. For researchers, the study extends the literature by isolating the direct, rather than composite, effects of board independence and creative accounting on distress within a single, methodologically consistent panel framework. For bank managers and boards, the results offer evidence-based guidance on how much weight to place on numerical board-independence compliance relative to other risk-management priorities. For regulators, including the Central Bank of Nigeria, the Financial Reporting Council, and the Securities and Exchange Commission, the findings provide empirical input for refining supervisory priorities around board oversight and loan-loss provisioning. For investors and depositors, the study clarifies which governance and accounting signals are, and are not, reliable predictors of distress in the current Nigerian regulatory environment.

Scope of the Study

The study is confined to eleven Deposit Money Banks continuously listed on the Nigerian Exchange Group throughout the period 2015 to 2024, selected purposively based on the availability and completeness of governance and financial data. The analysis relies exclusively on secondary data drawn from audited annual reports, and applies panel data regression techniques to examine the direct relationships between board independence, creative accounting practices, and financial distress, without extending to the mediating and moderating dimensions addressed in a companion article.

Literature Review

Conceptual Review

Board Independence

Board independence refers to the extent to which a company's board of directors comprises members who are free from management influence and have no material relationships with the firm capable of impairing their objectivity (Hermalin & Weisbach, 2003). Independent directors are typically non-executive members who do not participate in day-to-day management and have no significant financial, familial, or business ties to the firm or its executives. In empirical governance research, board independence is commonly measured as the proportion of independent, non-executive directors relative to total board size. Larger proportions of independent directors are theoretically expected to enhance monitoring effectiveness by bringing diverse expertise and reducing conflicts of interest (Pucheta-Martínez & Gallego-Álvarez, 2020). In banks specifically, independence is particularly relevant to the oversight of discretionary reporting areas such as loan loss provisioning and asset reclassification. However, where independence exists only in form rather than substance, owing to politically influenced appointments or weak enforcement, its monitoring effectiveness is significantly reduced (Adegbite, 2015; Okafor, 2021). Recent evidence by Imahsunu and Ogu (2025) further demonstrates that board characteristics remain important governance mechanisms in deposit money banks, although their effectiveness depends largely on the quality of governance implementation and institutional oversight rather than board composition alone.

Creative Accounting Practices

Creative accounting describes the deliberate use of the flexibility embedded

within accounting rules and standards to shape reported financial performance and position in a manner that departs from underlying economic reality (Amat & Gowthorpe, 2010; Shah, 2018). It does not always amount to outright fraud; rather, it involves the intentional exercise of judgement in areas such as valuation, classification, and the timing of transactions. Within the banking sector, creative accounting is most commonly examined through the lens of discretionary loan loss provisions (DLLP), which capture the portion of provisioning that cannot be explained by objective drivers such as non-performing loans and loan growth, and which is therefore attributable to managerial discretion (Beatty & Liao, 2014; Ajekwe et al., 2017). Managers may understate provisions to inflate reported profits during favourable periods or over-provision in strong years to build reserves that can later be released to smooth earnings (Ozili, 2020). While such adjustments may be technically compliant with IFRS, they can obscure deteriorating asset quality and delay the recognition of emerging financial weakness (Ahn & Gam, 2024). Similarly, Imahsunu and Osamwonyi (2025) argue that compliance with prudential guidelines significantly influences the financial performance of quoted deposit money banks in Nigeria by limiting excessive managerial discretion in financial reporting and strengthening regulatory discipline.

Theoretical Framework

Agency Theory

This article is anchored on Agency Theory, originally propounded by Jensen and Meckling (1976), which conceptualises the firm as a nexus of contracts between principals (shareholders and depositors) and agents (managers) entrusted with running the enterprise on their behalf. Agency problems arise because managers, as agents, may pursue self-serving objectives, including bonus maximisation and job security, rather than the interests of principals,

particularly where monitoring is weak (Adegbite, 2015). In the banking context, such opportunism can manifest as discretionary manipulation of loan loss provisions to present an inflated picture of financial health. Corporate governance mechanisms, especially board independence, are theorised to reduce agency costs by enhancing oversight and constraining managerial discretion, thereby lowering the risk of financial distress that would otherwise arise from unchecked opportunism (Adeyemi & Ashafoke, 2024). This theoretical lens underpins both hypotheses examined in this article, linking the presumed monitoring role of independent directors and the presumed distortive role of discretionary provisioning directly to distress outcomes.

Empirical Review

Empirical evidence on the governance–distress relationship is mixed. Adu and Alagidede (2019) found that board independence and audit quality significantly reduced risk-taking behaviour among African banks, while Adeyemi and Ashafoke (2024), studying ten Nigerian deposit money banks between 2010 and 2021, reported that greater board independence significantly lowered the risk of financial distress measured by the Altman Z-score. In contrast, Okafor (2021) argued that board independence in Nigeria often fails to deter opportunistic behaviour because appointments are sometimes politically influenced, thereby limiting the objectivity of nominally independent directors.

On the relationship between creative accounting and distress, international evidence from Habib et al. (2021) and Kusnadi and Wei (2020) associates income smoothing and accrual-based earnings management with heightened bankruptcy

risk. Nigerian evidence is similarly supportive in some respects: Eze and Nweze (2022) found that reclassification of loans and delayed recognition of non-performing assets significantly predicted distress among deposit money banks, while Uwuigbe et al. (2021) confirmed that creative accounting weakens the reliability of reported profits. However, other studies conducted in tightly regulated banking environments, including Kanagaretnam et al. (2010) and Tran (2020), suggest that the effect of discretionary provisioning on failure risk is muted where supervisory oversight and capital adequacy enforcement are strong, a pattern that is directly relevant to the post-2009 Nigerian regulatory environment.

Taken together, the reviewed studies reveal a lack of consensus on whether board independence and creative accounting practices exert direct, standalone effects on financial distress once bank-specific controls and regulatory context are accounted for, particularly using recent, post-IFRS 9 Nigerian data. This gap justifies the present empirical investigation.

Methodology

Research Design

The study adopts an ex post facto research design within a positivist research philosophy, appropriate where the variables under investigation, such as board independence, discretionary provisioning, and financial distress, cannot be experimentally manipulated but are instead observed through historical, archival data (Creswell & Creswell, 2023). A panel data structure is employed, combining cross-sectional and time-series observations across eleven banks and ten years, which improves estimation efficiency and controls for unobserved bank-specific heterogeneity (Baltagi, 2021).

Population of the Study

The population comprises all thirteen Deposit Money Banks listed on the Nigerian

Exchange Group as of 2024, operating under the Nigerian Code of Corporate Governance (2018), Central Bank of Nigeria prudential guidelines, and International Financial Reporting Standards.

Sample Size and Sampling Technique

A purposive sampling technique was used to select eleven of the thirteen deposit money banks, namely Access Bank, Ecobank, Fidelity Bank, First Bank, First City Monument Bank, Guaranty Trust Bank, Stanbic IBTC Bank, Sterling Bank, United Bank for Africa, Wema Bank, and Zenith Bank, based on the availability, completeness, and consistency of secondary data for the period 2012–2024 (Etikan, 2020). This represents approximately 84 percent of the study population, a proportion considered methodologically adequate for panel-based inference in small populations (Krejcie & Morgan, 1970).

Method of Data Collection

The study relies exclusively on secondary data obtained from the audited annual financial statements of the sampled banks, supplemented with sector-level indicators from the Nigerian Exchange Group Factbook and Central Bank of Nigeria Statistical Bulletins. The use of independently audited and regulator-verified data minimises subjectivity and researcher-induced bias, and supports the objectivity central to the positivist research philosophy adopted.

Measurement of Variables

Financial distress (the dependent variable) is proxied by the Ohlson O-Score, a continuous distress score computed from accounting-based indicators of firm size, leverage, liquidity, profitability, and performance trends (Ohlson, 1980). Board independence is measured as the proportion of independent, non-executive directors to total board size. Creative accounting practices are proxied by discretionary loan loss provisions

(DLLP), obtained as the residuals from a fixed-effects regression of loan loss provisions, scaled by lagged total loans, on non-performing loans scaled by lagged total loans and loan growth (Beatty & Liao, 2014; Ajekwe et al., 2017). Bank size (the natural logarithm of total assets), return on assets, and leverage (total liabilities to total assets) are included as control variables.

Validity and Reliability of Instrument

As the study relies wholly on secondary data drawn from audited financial statements independently verified by external auditors and regulatory authorities, validity and reliability are supported by the statutory audit process, IFRS-based reporting requirements, and Central Bank of Nigeria disclosure regulations, which collectively minimise the risk of measurement error inherent in self-reported primary data.

Method of Data Analysis

The study employs panel data regression techniques. Both fixed-effects and random-effects models were initially estimated, and the Hausman specification test was applied to determine the appropriate estimator. The test yielded a chi-square statistic of 20.50 ($p = 0.0023$), favouring the fixed-effects model. Diagnostic tests, including the Variance Inflation Factor for multicollinearity, the Breusch–Pagan/Cook–Weisberg test for heteroskedasticity, a residual-based Breusch–Godfrey test for serial correlation, and Pesaran's test for cross-sectional dependence, were conducted to validate model specification. Given the evidence of cross-sectional dependence, all models were estimated using fixed effects with cluster-robust standard errors at the bank level. All analyses were conducted using STATA version 19.

Model Specification

Let $i = 1, 2, \dots, 11$ denote individual banks and $t = 2015, \dots, 2024$ denote time. The following panel regression models are specified to test the two hypotheses of this article.

Model 1 (Board Independence and Financial Distress, H01):

$$FDit = \beta_0 + \beta_1 BOI_{it} + \sum \beta_k X_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

Model 2 (Creative Accounting Practices and Financial Distress, H02):

$$FDit = \beta_0 + \beta_1 DLLP_{it} + \sum \beta_k X_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

where FD is financial distress (Ohlson O-Score), BOI is board independence, DLLP is discretionary loan loss provisions, X is a vector of control variables (bank size, return on assets, and leverage), μ_i captures unobserved bank-specific effects, λ_t controls for time-specific effects, and ε_{it} is the idiosyncratic error term. Hypotheses H01 and H02 are tested through the statistical significance of β_1 in Models 1 and 2, respectively.

Results and Discussion

Analysis of Research Objectives

Objective One: Board Independence and Financial Distress

The fixed-effects regression estimating Model 1 produced a within R^2 of 0.8988, indicating that the model explains approximately 89.9 percent of the year-to-year change in financial distress within banks. The estimated ρ of 0.3833 confirms that a substantial share of the variation in distress is attributable to unobserved, time-invariant bank-specific effects, justifying the fixed-effects approach.

Table 1: Fixed Effects Regression Results for Board Independence and Financial Distress

Variable	Coefficient	Robust Std. Error	t-statistic	p-value
BOI	0.7822	1.9100	0.41	0.691
BS	-1.0471	0.1882	-5.56	0.000***
ROA	-6.2324	8.6937	-0.72	0.490
LEV	6.8466	0.1575	43.48	0.000***
Constant	12.3973	4.0360	3.07	0.012**

Note: Within $R^2 = 0.8988$; F-statistic = 11,241.58 ($p = 0.0000$); $\rho = 0.3833$. ***, ** denote significance at 1% and 5% respectively.

Source: Researcher's Computation using STATA 18.0 (2026).

As shown, board independence (BOI) carries a positive but statistically insignificant coefficient ($\beta = 0.7822$, $p = 0.691$), indicating that the proportion of independent directors does not exert a statistically meaningful influence on financial distress. Among the control variables, bank size is negatively and significantly associated with distress ($\beta = -1.0471$, $p < 0.01$), while leverage is positively

and significantly associated with distress ($\beta = 6.8466$, $p < 0.01$).

Objective Two: Creative Accounting Practices and Financial Distress

The fixed-effects estimation of Model 2 similarly produced strong explanatory power, with a within R^2 of 0.8984 and a highly significant F-statistic.

Table 2: Fixed Effects Regression Results for Creative Accounting Practices and Financial Distress

Variable	Coefficient	Robust Std. Error	t-statistic	p-value
DLLP	0.8595	3.6919	0.23	0.821
BS	-1.0204	0.2388	-4.27	0.002***
ROA	-6.2629	8.8965	-0.70	0.498
LEV	6.8378	0.1706	40.07	0.000***
Constant	12.2920	5.3607	2.29	0.045**

Note: Within $R^2 = 0.8984$; F-statistic = 4,751.25 ($p = 0.0000$); $\rho = 0.3648$. ***, ** denote significance at 1% and 5% respectively.

Source: Researcher's Computation using STATA 18.0 (2026).

Discretionary loan loss provisions (DLLP), the proxy for creative accounting practices, carry a positive but statistically insignificant coefficient ($\beta = 0.8595$, $p = 0.821$), indicating that discretionary provisioning does not exert a statistically meaningful direct effect on financial distress once bank-specific effects and control variables are accounted for. As in Model 1, bank size is negatively and significantly related to distress, while leverage remains a strong positive and significant predictor.

Test of Hypotheses

- H₀₁:** Board independence has no significant effect on financial distress in Nigerian listed deposit money banks. With a t-statistic of 0.41 and a p-value of 0.691, greater than the 5 percent threshold, the study fails to reject H₀₁.
- H₀₂:** Creative accounting practices have no significant effect on financial distress in Nigerian listed deposit money banks. With a p-value of 0.821, the study fails to reject H₀₂.

Discussion of Findings

The finding that board independence does not significantly affect financial distress partially challenges Agency Theory's assumption that independent directors function as effective monitors capable of constraining managerial opportunism. Instead, the result suggests that board independence in Nigerian banks may be largely formalistic, satisfying regulatory thresholds without translating into substantive oversight. This is consistent with Ehikioya (2019), Adegbite and Nakajima (2021), and Imahsunu and Ogu (2025), who report that board independence in Nigeria is frequently undermined by insider influence and regulatory capture, and with Adeyemi and Ashafoke (2024), who similarly found no significant relationship between

board independence and distress. The result contrasts, however, with evidence from more developed governance environments, such as Claessens and Yafeh (2012), where stronger legal enforcement enables independent directors to meaningfully constrain distress risk, underscoring that the effectiveness of board independence is contingent on institutional context rather than board composition alone.

The insignificant effect of creative accounting practices on financial distress represents a notable departure from the predictions of Positive Accounting Theory, which anticipates that opportunistic reporting choices erode transparency and, over time, precipitate distress (Healy & Wahlen, 1999; Dechow et al., 2011). This finding aligns with Nigerian evidence from Ajekwe et al. (2017), Uwuigbe et al. (2021) and Imahsunu and Osamwonyi (2025), who note that prudential guidelines issued by the Central Bank of Nigeria and post-2009 supervisory reforms have constrained the extent to which discretionary provisioning can escalate into observable distress, and with international evidence from Kanagaretnam et al. (2010) and Tran (2020) showing that regulatory oversight mutes the loan-loss-provisioning-distress link. It diverges, however, from studies such as Wilson-Oshilim et al. (2024) and Ogunleye (2021), which identify creative accounting as a significant predictor of corporate failure, a divergence plausibly explained by the fact that Nigerian banks, unlike many non-financial firms, operate under stringent IFRS 9 expected-credit-loss requirements and intensive CBN surveillance that limit the persistence of discretionary provisioning. Overall, the evidence suggests that both board independence and creative accounting practices may be more consequential as conditioning or transmission factors than as standalone, direct determinants

of financial distress in the tightly regulated Nigerian banking sector, a possibility examined further in a companion article addressing the mediating and moderating dimensions of the governance–accounting–distress nexus.

Conclusion

This study examined the direct effects of board independence and creative accounting practices on financial distress among eleven Nigerian listed deposit money banks over the period 2015–2024. Using fixed-effects panel regression with cluster-robust standard errors, the study found that neither board independence nor discretionary loan loss provisioning exerted a statistically significant direct effect on financial distress, while leverage and bank size emerged as the dominant, consistently significant drivers of distress outcomes. These findings indicate that internal governance structures and accounting discretion, when considered in isolation, do not independently determine financial distress within a banking sector characterised by intensive regulatory oversight. Rather, regulatory and prudential controls appear to play a more dominant role than internal board-level mechanisms in shaping distress outcomes, suggesting that governance effectiveness in Nigerian banks is heavily contingent on the broader institutional and supervisory environment.

Recommendations

- i. The Central Bank of Nigeria and other regulatory authorities should strengthen the effectiveness of board independence by emphasizing the competence, objectivity, and active participation of independent directors rather than merely ensuring compliance with minimum board composition requirements.
- ii. Regulators and bank management should sustain strict monitoring of creative

accounting practices through enhanced compliance with IFRS 9, regular review of loan loss provisioning, and improved financial reporting transparency to maintain the integrity of financial statements.

Limitations of the Study

The study is limited to eleven listed deposit money banks with complete data for the period examined, which may constrain the generalisability of the findings to unlisted banks, microfinance banks, and other financial institutions. In addition, board independence and creative accounting practices are examined only in terms of their direct effects; potential mediating and moderating pathways are addressed separately.

Suggestions for Further Studies

- i. Future studies should investigate the effect of other corporate governance mechanisms, such as board diversity, board expertise, audit committee effectiveness, or CEO duality, on financial distress in the Nigerian banking sector.
- ii. Future research should examine creative accounting using alternative proxies, such as accrual earnings management, real earnings management, or earnings smoothing, to determine whether different measures produce similar results regarding financial distress.

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