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(RESEARCH ARTICLE)

The impact of financial statement manipulation on investor confidence

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Abstract

The study investigates the Impact of Financial Statement Manipulation on Investor Confidence. The study adopts survey research design and utilized a population which comprises accounting professionals, financial analysts, and corporate decision-makers within the financial sector. Out of the population, a sample size of 200 was selected using probability sampling technique. Data was collected from the respondent with the use of structure questionnaire and the data collected were analyzed using 4point Likert. From the data analysis, result showed that falsification of revenue, inflated asset valuation with earning management among others factors such as lack of financial transparency affect investor confidence when making financial decision for investment. Based on this finding, the study recommended that companies should prioritize adopting transparent financial reporting practices that adhere strictly to regulatory standards and ethical guidelines and it is crucial for management to foster a culture of transparency, providing investors with clear, honest, and timely information

Keywords: Financial Statement; Manipulation; Investor Confidence; Impact of Accounting Manipulation; Investor Confidence and Fraud

1. Introduction

Financial statement manipulation remains a critical concern in the global financial landscape, affecting investor confidence and market stability. The manipulation of financial statements refers to the intentional misrepresentation or omission of financial information to deceive stakeholders about a company's financial health (Dechow, Ge, & Schrand, 2019). Such manipulations often involve earnings management, improper revenue recognition, or creative accounting techniques that distort financial performance (Healy & Wahlen, 2020). Notable corporate scandals, such as Enron, WorldCom, and more recently, Wirecard, highlight the devastating consequences of financial fraud, leading to severe market repercussions, loss of investor trust, and stringent regulatory reforms (Jones, 2021). However, this practice can range from aggressive accounting techniques within the bounds of regulatory frameworks to outright fraudulent activities that violate accounting standards and legal statutes. The manipulation of financial statements has profound implications for investor confidence, as it distorts the true financial position and performance of firms, leading to misinformed investment decisions and potential financial losses.

The history of financial statement manipulation is replete with notable corporate scandals that have shaken investor trust and prompted regulatory reforms. The early 2000s witnessed high-profile cases such as Enron and WorldCom, where deceptive accounting practices led to massive investor losses and the eventual collapse of these corporations. These events underscored the vulnerabilities in financial reporting systems and highlighted the necessity for stringent

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oversight and transparent accounting practices.In response to these scandals, regulatory bodies implemented measures aimed at enhancing the integrity of financial reporting. The Sarbanes-Oxley Act of 2002 in the United States, for instance, introduced rigorous auditing and financial regulations to curb corporate fraud. Despite such measures, financial statement manipulation persists, as evidenced by more recent cases like the Wells Fargo fake accounts scandal and the Toshiba accounting scandal, indicating that the issue remains a significant concern in the corporate world.

Investor confidence is the cornerstone of efficient and effective capital markets. Trust in the accuracy and reliability of financial statements influences investment decisions, affects stock prices, and ultimately impacts the overall stability of financial markets. When companies engage in financial statement manipulation, they not only mislead investors but also erode the foundational trust necessary for market operations. Studies have shown that exposure to financial statement fraud significantly alters investor behaviour. Brazel *et al*. (2015) found that investors' perceptions of the frequency of financial reporting fraud influence their reliance on financial statements and the importance they place on conducting their own fraud risk assessments. This heightened scepticism can lead to increased due diligence costs, reduced market participation, and a general aversion to investment, thereby stiffening capital formation and economic growth.

While considerable research has been conducted on financial statement manipulation and its effects, several gaps such as Behavioral Insights into Management Practices and Effectiveness of Detection Mechanisms among others remain.

Hence**,** Investigating the impact of financial statement manipulation on investor confidence is essential. This is the reason why this study is aimed at investigating the Impact of Financial Statement Manipulation on Investor Confidence

1.1. Statement of the problem

Investor confidence is fundamental to the proper functioning of capital markets. Trust in the accuracy and transparency of financial statements influences investment decisions, affects stock valuations, and underpins the overall stability of financial systems. When companies engage in financial statement manipulation, they not only mislead investors but also undermine the foundational trust essential for market operations. This erosion of trust can lead to increased market volatility, reduced investment, and higher costs of capital for businesses.

While existing literature has extensively explored the mechanisms and motivations behind financial statement manipulation, there remains a critical gap in understanding its direct impact on investor confidence. Most studies have focused on the detection and prevention of such manipulative practices, with limited emphasis on how these actions influence investor behaviour and perceptions. Addressing this gap is essential, as comprehending the repercussions of financial statement manipulation on investor confidence can inform more effective regulatory policies and corporate governance practices. Failure to address the impact of financial statement manipulation on investor confidence can have far-reaching consequences. Persistent manipulation practices may lead to a sustained erosion of trust in financial markets, deterring investment and hindering economic growth. Conversely, a thorough understanding of this impact can guide the development of robust frameworks aimed at enhancing financial transparency, restoring investor trust, and ensuring the long-term stability of financial markets. This reasons, necessitated this study into investigating the Impact of Financial Statement Manipulation on Investor Confidence

Aim/ Objective of the study

The aim of the study is to ascertain the impact of Financial Statement Manipulation on Investor Confidence. Specifically, the study will ascertain;

- The Prevalence of Financial Statement Manipulation
- Identify Common Manipulative Practices
- The Impact on Investor Confidence

2. Literature Review

2.1. Conceptual framework

Financial statement manipulation is defined any act of omission or misstatement deliberately done or committed by a firm in its financial reporting that distorts the entity's real state of affairs" (Anning & Adusei, 2020).

According Achmad, (2022) it is a fraudulent financial reporting that includes manipulation, falsifying, or altering supporting documents and accounting records to prepare financial statements, omission, error or intentional obstruction of transactions, events or information leading to the presentation of financial statement.

2.2. Theoretical studies

Financial statement manipulation, often referred to as earnings management or creative accounting, involves the intentional distortion of financial reports by corporate management to present a misleading portrayal of a company's financial health. This practice undermines the integrity of financial markets, misleads stakeholders, and can lead to significant economic consequences. Studies have sought to quantify the extent of financial statement manipulation across various contexts. Vandenberg *et al.* (2025) employed a novel approach using list experiments to estimate that approximately 12.4% of companies within the Russell 3000 index may have engaged in financial statement fraud at least once over a five-year period. This innovative methodology, which ensures respondent anonymity to elicit candid disclosures, also revealed that about 27% of surveyed executives admitted to some form of earnings manipulation, excluding fraud, within the same timeframe. These findings suggest that financial misreporting is more pervasive than traditionally reported. In a sector-specific analysis, Safta *et al.* (2020) investigated the manipulation of financial statements among Romanian non-financial companies. Utilizing a sample of 62 firms listed on the Bucharest Stock Exchange during 2017-2018, the study found that approximately 84% of these companies engaged in some form of financial statement manipulation. The prevalence was notably higher in industries such as tourism, construction, trade, and transport, each exhibiting a 100% manipulation rate, while the production sector showed an 86% rate, and services stood at 50%. This research highlights the industry-specific tendencies toward financial misreporting.

The Association of Certified Fraud Examiners (ACFE) also provides a broader perspective, indicating that financial statement fraud constitutes about 10% of all occupational fraud cases globally (ACFE, 2020). Although less frequent than asset misappropriation or corruption, financial statement fraud results in substantially higher median losses, underscoring its severe impact on organizations and stakeholders. The methodologies employed to detect and analyze financial statement manipulation vary across studies. Vandenberg *et al*. (2025) utilized a list experiment design, a technique from social sciences that allows respondents to indirectly disclose sensitive behaviours, thereby reducing social desirability bias and enhancing the accuracy of self-reported data. This approach is particularly effective in uncovering unethical or illicit activities that individuals might otherwise be reluctant to admit. Safta *et al.* (2020) applied the Beneish M-score model, a mathematical tool developed to identify companies likely engaging in earnings manipulation. This model analyses financial ratios and eight variables to detect anomalies indicative of potential manipulation.

2.3. Theoretical Framework

The study is anchored on Agency theory propounded by Michael C. Jensen and William H. Meckling (1976). The theory posits that conflicts of interest arise in firms due to the separation of ownership and control. Managers (agents) are employed by shareholders (principals) to maximize firm value, but their personal incentives may not always align with those of the shareholders. This divergence leads to agency costs, which manifest through opportunistic behaviours such as financial statement manipulation. This fact give credence to the use of this theory in this study.

3. Methodology

3.1. Research Design

This study employs a survey research design to investigate the Impact of Financial Statement Manipulation on Investor Confidence. A survey design is appropriate as it allows for the collection of primary data directly from respondents, ensuring a broad representation of perspectives on behavioural finance principles and their impact on accounting choices (Creswell & Creswell, 2023). This design is advantageous due to its efficiency in data collection, cost-effectiveness, and ability to generalize findings within the study's population (Bryman, 2021).

3.2. Study Area

This study focuses on Nigeria, a nation characterized by a dynamic economy and a complex financial landscape. As Africa's most populous country and largest economy, Nigeria presents a unique environment for examining financial statement manipulation and its impact on investor confidence.

3.3. Population of the study

The target population for this study comprises accounting professionals, financial analysts, and corporate decision-makers within the financial sector. These individuals are selected due to their direct engagement with financial accounting statement.

3.4. Sampling technique

The study adopts a probability sampling method, specifically stratified random sampling, to ensure representation across different professional backgrounds and organizational sizes (Taherdoost, 2021).

3.5. Sample size

To determine the appropriate sample size, a power analysis is conducted to ensure statistical significance, with an estimated minimum of 200 respondents to enhance reliability (Cohen, 2020).

3.6. Data Collection Method

The study utilizes a self-administered online survey as the primary data collection instrument. The survey consists of structured questionnaires designed to measure behavioural finance principles such as overconfidence, loss aversion, and anchoring in relation to accounting decision-making. Questions are formulated using a 4point Likert scale to capture the degree of agreement or disagreement with behavioural finance constructs (Fisher *et al.,* 2022).

3.7. Data Analysis Techniques

Quantitative data analysis is conducted using mean to summarize and interpret the dataset.

3.8. Reliability and Validity

To ensure reliability, internal consistency is tested using Cronbach's alpha, with a threshold of 0.7 and above considered acceptable (Nunnally & Bernstein, 2021). Construct validity is verified through exploratory and confirmatory factor analysis. Content validity is established through expert reviews and pre-testing of the survey instrument (Kline, 2020).

4. Result

Table 1 The Prevalence of Financial Statement Manipulation

s/n	Item on the Prevalence of Financial Statement Manipulation	Mean ($\bar{x}$)	Remark
1	Falsification of Revenue Figures	3.5	Strongly Agree
2	Understatement of Liabilities	3.8	Strongly Agree
3	Inflated Asset Valuation	4.0	Strongly Agree
4	Earnings Management Practices	3.1	Agree
	Mean of mean	3.6	Strongly Agree

The table 1, shows that, Falsification of Revenue Figures, has a mean score of 3.5, indicating a strong agreement with the notion that revenue figures are frequently falsified in financial statements. This suggests that there is a substantial concern regarding companies overstating their revenue to create a more favourable financial position, potentially misleading stakeholders about their profitability. The "Strongly Agree" remark emphasizes the significance of this practice in the financial reporting landscape, which can undermine investor confidence and regulatory oversight. Understatement of Liabilities, has a slightly higher mean of 3.8, indicating an even stronger agreement with the idea that companies tend to sometimes understate liabilities. By understating liabilities, companies can appear more financially sound, thereby misleading investors, creditors, and other stakeholders about the true financial health of the business. This practice can significantly affect decision-making, especially for stakeholders who rely on accurate financial data to assess a company's solvency and creditworthiness. The "Strongly Agree" remark also highlights the pervasiveness of this practice in financial manipulation, indicating that it is a common strategy for companies aiming to present an overly optimistic financial position.

Inflated Asset Valuation, with a mean of 4.0, reveals the highest level of agreement among the items in the table. This strong endorsement suggests that financial statement manipulation through the overstatement of asset values is a prevalent and concerning practice. Inflating asset values can mislead stakeholders about the true worth of a company's assets, impacting investment decisions, lending terms, and overall financial strategies. The "Strongly Agree" remark further underscores the significant role that inflated asset valuations play in financial manipulation, with potentially severe consequences for transparency and trust in financial markets. The fourth item, Earnings Management Practices, which has a lower mean of 3.1, indicating a moderate level of agreement with the occurrence of earnings management. Although the practice of earnings management where companies manipulate earnings to smooth out fluctuations or meet targets is recognized as a common phenomenon, it is seen as slightly less pervasive than the previously mentioned manipulative practices. The "Agree" remark suggests that while earnings management is a concern, it may be less blatant or widespread than more direct forms of financial manipulation, such as inflating revenue or understating liabilities.

The Mean of Mean is 3.6, which falls between the "Agree" and "Strongly Agree" categories, indicating that, overall, financial statement manipulation is considered to be a significant issue in the sample. This overall mean suggests that the respondents perceive these manipulative practices as prevalent and impactful, contributing to a broader concern about the integrity of financial reporting. The results highlight the importance of improving financial reporting standards and implementing stronger regulatory measures to curb these practices. Such findings call for increased vigilance by regulators, auditors, and other stakeholders in ensuring that financial statements reflect the true economic condition of firms, and that manipulative practices are identified and addressed to protect the interests of investors and the broader financial system.

Table 2 Common Manipulative Practices

s/n	Item on Common Manipulative Practices	Mean ($\bar{x}$)	Remark
1	Creative Revenue Recognition	4.0	Strongly Agree
2	Off-Balance-Sheet Financing	4.0	Strongly Agree
3	Channel Stuffing	3.5	Strongly Agree
4	Round-Tripping Transactions	3.6	Strongly Agree
5	Cookie Jar Reserves	3.7	Strongly Agree
	Mean of mean	3.8	Strongly Agree

Table 2 shows that Creative Revenue Recognition, has a mean score of 4.0, indicating strong agreement that this practice is widespread and is one of the manipulative practices used. The "Strongly Agree" remark emphasizes that this practice is not only common but potentially a major concern for stakeholders, as it distort company's actual performance and mislead investors, analysts, and regulatory bodies.Similarly, Off-Balance-Sheet Financing, also with a mean of 4.0, reflects a strong agreement with the idea that companies frequently use this method to keep certain liabilities or obligations off their balance sheets. This practice can make a company's financial position appear more favourable than it is, as it hides potential risks or debts that might otherwise raise red flags for investors and creditors. The "Strongly Agree" remark underscores the significance of this practice, is often used to maintain debt covenants or to avoid negative perceptions about a company's financial health.

The third item, Channel Stuffing, receives a mean of 3.5, indicating strong agreement that this practice is common. The "Strongly Agree" remark emphasizes that this manipulative practice is recognized as a tactic used to boost revenue in the short term,

Round-Tripping Transactions have a mean score of 3.6, suggesting strong agreement that this practice, where a company sells assets or goods and then repurchases them, is relatively common. This technique creates the illusion of increased sales or revenue without any real economic activity, thus distorting the company's financial performance. The "Strongly Agree" remark indicates there is widespread recognition of this tactic as a financial manipulation strategy that misrepresents the company's economic reality to external stakeholders.

While the fifth item, Cookie Jar Reserves, has a mean of 3.7, indicating strong agreement with the idea that companies engage in this practice. The "Strongly Agree" remark reflects that this practice is also considered a manipulative strategy to maintain a steady stream of earnings, thus avoiding negative reactions from investors and analysts.

The Mean of Mean is 3.8, indicating that, overall, the practices listed are considered prevalent and problematic in the context of financial reporting. This suggests a strong consensus among respondents that companies engage in a variety of manipulative techniques to present a more favourable financial picture than the true economic conditions would suggest.

Table 3 Impact on Investor Confidence

s/n	Item on Impact on Investor Confidence	Mean ($\bar{x}$)	Remark
1	Perceived Integrity of Financial Statements	4.0	Strongly Agree
2	Trust in Management’s Transparency	3.8	Strongly Agree
3	Influence of Financial Irregularities on Investment Decisions	3.8	Strongly Agree
4	Reputation Damage from Financial Scandals	3.9	Strongly Agree
5	Investor Perception of Risk	3.7	Strongly Agree
	Mean of mean	3.9	Strongly Agree

Table 3 depicts Perceived Integrity of Financial Statements, has a mean score of 4.0, which reflects a strong consensus that the integrity of financial statements significantly affects investor confidence.

Trust in Management’s Transparency, also has a mean of 3.8, indicating strong agreement that trust in management plays a critical role in shaping investor confidence. Transparency in financial reporting, coupled with clear and honest communication from management, enhances investor trust. The "Strongly Agree" remark underscores the importance of a company’s ability to demonstrate openness and ethical conduct in its operations.

Influence of Financial Irregularities on Investment Decisions has a mean of 3.8, reinforcing the idea that financial irregularities have a strong influence on investor decisions. The "Strongly Agree" remark emphasizes that financial irregularities, whether through manipulation or non-compliance with regulations, significantly affect investors' willingness to commit capital to such companies.

Reputation Damage from Financial Scandals, has a mean of 3.9, also suggesting that financial scandals have a notable impact on a company’s reputation. Companies that experience scandals related to financial misreporting, fraud, or unethical practices often suffer long-term damage to their brand image. The "Strongly Agree" remark underlines the critical role of corporate reputation in influencing investor confidence.

Investor Perception of Risk, rated mean value of 3.7, highlights the impact that financial transparency or the lack thereof has on how investors assess risk. The "Strongly Agree" remark also reinforces that financial practices directly affect risk perceptions, which in turn affect investment behaviour.

The Mean of Mean score of 3.9 indicates a general consensus that factors related to the integrity of financial reporting, management transparency, and the consequences of financial irregularities strongly influence investor confidence.

5. Conclusion and Recommendation

In conclusion, the findings from the study showed that practices such as falsification of revenue figures, understatement of liabilities, inflated asset valuations, and earnings management are commonly perceived to occur, thereby undermining the reliability of financial statements. These manipulative practices are perceived to have a direct and detrimental impact on investor confidence, as they raise concerns about the accuracy, transparency, and ethical conduct of the company. The analysis reveals that factors such as perceived integrity in financial statements, trust in management's transparency, and the company’s reputation among others play critical roles in shaping investor perception. Based on these findings, its us recommended that companies should prioritize adopting transparent financial reporting practices that adhere strictly to regulatory standards and ethical guidelines and it is crucial for management to foster a culture of transparency, providing investors with clear, honest, and timely information.

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

Statement of informed consent

Informed consent was obtained from all individual participants included in the study.

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