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EFFECT OF BOARD SIZE ON EARNINGS MANAGEMENT OF FAST MOVING CONSUMER GOODS FIRMS IN NIGERIA

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ABSTRACT

Fast Moving Consumer Goods (FMCG) firms are faced with an obligation to report positive earnings growth and also meet analysts' forecasts. However, economic and operational issues could cause a company to report otherwise, thereby, encouraging managers to manipulate earnings in an attempt to make the company appear to meet its shareholder's expectations. Corporate governance mechanisms are potent means of curbing these manipulations so as to ensure quality financial reporting. This research considered whether there was a significant relationship between board size and earnings management in fast moving consumer goods firms in Nigeria. The study had a sample size of 15 listed fast moving consumer goods firms in Nigeria. The data analyzed in this study were collected from the annual reports of the 15 listed firms for the period 2012 to 2015 using multiple linear regression models. Ordinary Least Square regression analysis was employed. Data were analysed using the STATA 13.0 software and excel spreadsheet. Diagnostic tests were also carried out to test the robustness of the research instruments. Findings from the study showed that board size were positively related to earnings management. The study concluded that limiting the number of members on the board in fast moving consumer goods firms will help in regulating earnings management in the sector.

Keywords: Earnings, goods, managers, financial, governance.

1.0 INTRODUCTION

Earnings management encompasses a wide range of accounting techniques implemented by the management of a firm to achieve a specific earnings objective (Uwuigbe, Uwuigbe and Okorie, 2015). It also refers to the deliberate misrepresentation of the financial condition of an enterprise accomplished through intentional misstatement or omission of amounts or disclosure in the financial statement to deceive financial statement users. The issue of earnings management has attracted a lot of attention from concerned entities such as government, accounting professionals, investors, financial regulators and the public especially with the multitude of corporate governance scandals (Kankanamage, 2015). Some of these corporate governance scandals are termed accounting scandals because their occurrences are highly related to material misstatements of financial statements. Some recent accounting scandals include the Sino-Forest

Corporation scandal of 2011 where a research report by Muddy Waters stated allegations of fraudulently inflated assets and earnings; Toshiba scandal of 2015 where its profits were said to have been inflated by nearly $2 billion over seven years which is more than four times its initial estimate, and so on (Uwuigbe, 2013). These current global trends of accounting scandals that have plagued large industries such as Unilever (Nigeria), Enron, Worldom, Hollinger, Adecco, Health South, Global Crossing, Tyco, Parmalat and TV Azteca necessitate a check into the practice of earnings maneuver. Several codes and statutes have been established over the years to address these scandals which include the Security and Exchange Commission (SEC) code on corporate governance in 2003 and reviewed in 2011. The code guides the operation and activities of public companies listed in the Nigerian Stock Exchange. This shows that Nigeria has responded with an effort to improve the financial reporting practices of companies by ensuring that they comply with these codes. Sections 246 and 247 of the Company and Allied Matters Act (2004) provide that all public companies in Nigeria must have a minimum of two directors on commencement. Although, the code of corporate governance is limited to public companies, especially those listed on the Nigeria Stock Exchange. Corporate governance is a concept that embodies the supervision of management in decision-making processes, both in the public and private sectors. The Board of Directors has been given the primary responsibility to ensure compliance and adherence to the principles and provisions of the code. This is because it is the duty of the Board to ensure that the company is properly managed by overseeing the effective performance which will protect and enhance shareholders' value. Based on the scale and complexity of the company's operation and activities, the board is expected to be of sufficient size and diversity of experience, thereby ensuring that independence, compatibility, and integrity are not compromised. The board should consist of executive and non-executive members. Hence, good governance by the board is essential to improve the quality of financial reporting which in turn has impact on the inventors' confidence. So, good corporate governance is expected to reduce the negative effects of earnings management as well as the likelihood of creative financial reporting arising from fraud and errors

In Nigeria, The Fast Moving Consumer Goods (FMCG) sector is part of the manufacturing industry that is involved in the production and marketing of food, beverages, home care products as well as personal care products which are purchased by consumers as fast as they are placed on the shelves. This sector generates a significant portion of the gross domestic product of many countries in Africa including Nigeria. This is why there is a serious need for improvement in this sector especially with the current state of the economy. The earnings of such companies are essentially expected to have high-level reliability and relevance as its stakeholders rely on it (Bala and Kumai, 2015). It is believed that accounting earnings provide useful and relevant financial information to investors and other decision makers. It has been argued that earnings can be said to be relevant only if its various users, including potential investors can rely on it. But, this needed reliability and relevance is threatened by earnings management. Earnings management therefore, may hide real performance and minimize the ability of shareholders and investors to make informed decisions. Earnings management most likely will lessen the quality of earnings reported in the financial statement and its usefulness in investment decision making as the accounting methods and treatments that better suit the interest of the managers than those that represent the financial position of the firm are selected, thereby reducing the confidence of investors.

The main purpose or objective of the study is to determine the effect of board size on earnings management of listed FMCG firms that are listed on the Nigeria Stock Exchange. Regardless of the different governance structures and frameworks, misappropriation of funds and alteration of financial reports in the interest of the management has remained prevalent in most developing economies including Nigeria (Uwuigbe *et al.,* 2015). Questioning the oversight function of the board, several researchers have measured the relationship between certain identified characteristics of the board such as board size.

Ho: There is no significant relationship between board size and earnings management of listed FMCG firms in Nigeria. This hypothesis shall be used to test the relationship between board size of FMCG firms and their earnings management.

2.0 LITERATURE REVIEW

Earnings management occupies a front row on the current debate on corporate failures. Firms exploit the assets that were acquired by equity capital and debt so as to achieve its main objective which is the maximization of its shareholders' wealth. Since investors are motivated by positive future firm performance, it is in the best interest of the company to report positive earnings and growth that will meet analysts' forecasts. However, it is most likely that firms would be unable to meet these expectations all the time and may consequentially suffer stock price decreases. This may cause them to manage earnings so as to meet shareholders' expectations and hold equity. Although, earnings management is not always viewed negatively (Rudra & Bhattacharjee, 2012), the currently accepted belief among accountants, regulators and standard setters are that, more often than not, earnings management is disadvantageous. It is primarily achieved through the exploitation of accounting choices from among Generally Accepted Accounting Principles (GAAP) and operating decisions.

Conceptual Framework (Earnings)

Positive earning is seen as the ultimate performance indicator of a company. It is the profit of a company accounted for in a particular period (usually a year) which is represented by the net income presented in the income statement and a summary item in financial statements. Earnings often represent firm performance and it conveys the value of the firm to investors. Most existing or prospective investors are expected to carefully observe earnings as one of the most effective accounting information on the income statement that reflects the financial strength of the firm in order to be able to make relatively basic evaluations on future prospects of the company. Earnings are vital indicators of a company's engagement in value-added activities (Musfiqur *et* *al.,* 2013). The theoretical value of a company's stock is the present value of its future earnings. So, companies with positive and higher earnings will automatically have higher share prices than those with lower earnings.

Earnings Management

Earnings management is the exploitation of a firm's opportunities in making accounting decisions. These opportunities may include the selection of accounting estimates that achieve the earnings target of a company and the timing of transactions such that it affects the net income of the company in line with the desires of the management. Earnings management is a purposeful intervention by the management of a firm in the process of financial reporting in order to gain personal or organisational benefits. Moreover, the act of managing earnings usually does not reflect the true performance of the firm. Earnings management is recognized as attempts by management to influence or manipulate reported earnings using specific accounting methods (Musfiqur, Mohammed and Jamil, 2013). Earnings management can be misleading as it may reduce transparency rather than make financial reports more informative. Earnings management can also be seen as sensible and legal. It will be deemed to be legal only if the adjustment of the reported earnings is in line with Generally Accepted Accounting Principles (GAAP). Conversely, earnings management may cease from being legal to fraudulent when it goes beyond the bounds of GAAP such as deferring expenses recognition and accelerating revenue recognition (Musfiqur *et al.,* 2013).

IFRS and Earnings Management

International Financial Reporting Standards (IFRS) which were adopted in 2005 in many countries around the world came into effect in Nigeria in 2011. The International Accounting Standards Board (IASB) issued several new, revised and amended standards.
One of the major goals of the IASB is to develop high-quality financial reporting standards that are internationally acceptable and meet the criteria of relevance, reliability and comparability.
Relevant studies examine the association between IFRS adoption and measures of earnings management. Aussenegg, Inwinkl and Schneider (2008) examined 17 countries and identified declining earnings management after IFRS adoption arguing that IFRS provides for higher disclosure information which increases the manipulation risk of being detected. Some of such findings are consistent with that of Christensen, Lee and Walker (2008) that earnings management decreases and timely loss recognition rises in Germany and Sweden after their IFRS adoption Capkun, Cazavan-Jeny, Jeanjean and Weiss (2011).
However, some other researchers suggest that IFRS has negative impacts on the quality of financial reporting. Extant literature across several countries like Australia, France, UK, Italy, and Germany has shown an increase in discretionary accruals. They argue that their findings confirm that principle-based standards are not a sufficient condition to mitigate earnings management (Callao and Jarne, 2010). IFRS carry a number of accounting choices such as cost

or fair value measurement for properties, which allow the firm to opt for the alternative which best fits its business thereby opening doors for earnings management. One reason for the difference in findings is that the various studies focus on different countries which have their own specific economic environment. Evidence indicates that the effect of IFRS on information quality is higher in countries with larger differences between domestic standards and IFRS (Aharony, Wang, & Yuan, 2010).

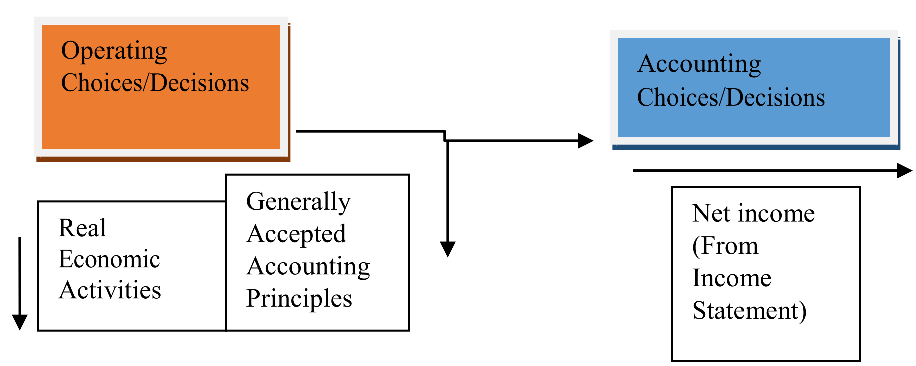
Methods of Earnings Management

According to Musfiqur *et al.,* (2013), there are two methods through which managers can achieve earnings management: by accounting choices or by operating decisions.

1) Accounting choices: These include decisions to implement new standards or wait for such standards to become mandatory. Any accounting choice outside the limits of GAAP becomes illegal. So, one could use the flexibility allowed in GAAP to adjust reported earnings without changing the underlying cash flows.

2) Operating decisions: To manage the underlying cash flows which could affect the reported income, managers could also change operating decisions such as adjustments of maintenance expenses for the period, the implementation of special discounts or incentive program just to help meet the revenue target for the period or even investment decisions or staffing. Earnings management aims to manage the cash flows of the period incorporating the revenue and expenses associated with the operations as a means of managing the earnings.
These methods of earnings management are associated with real economic costs because, whether accounting or operating choices are used, they tend to influence the activities of future accounting periods. This scenario can be illustrated with the model below:

Fig 1: Effects of Operating versus Accounting Choices



Source: Researchers' Model, 2019

Theoretical Framework (Corporate Governance)

Corporate governance is the framework, rules, systems, processes and relationship within and by which authority is exercised and controlled in corporations (Kang *et al.,*2013). It may also be defined as the system by which business organizations are directed and controlled. Corporate governance is a concept through which management supervision takes place in both private and public business organizations (Nugroho & Eko, 2011) Corporate governance structure expresses the distribution of rights and responsibilities among the board, managers, shareholders and other stakeholders by stating the rules and procedures for making decisions on corporate affairs (Gulzar, 2011). It can also impact on how the objectives and goals of firms are formulated and achieved, how risks are monitored and assessed, and how performance is optimized. Good corporate governance structures should encourage firms to create value and improve the quality of earnings and thus reduce earnings management (Kang *et al.,* 2013). There has been a wide range of theories (Badolato, Donelson and Ege, 2014) underpinning the issue of earnings management in relation to corporate governance. Such theories include: (i) Stewardship, (ii) stakeholders, (iii) resource dependence, and (iv) agency theories.

Agency theory: This study adopted the agency theory. This is because the theory best describes the relationship between managers and shareholders (who are majorly affected by the management of earnings) in relation to corporate governance.

Agency theory involves a contract under which the principal engages another party, called agent, to carry out some services on their behalf and delegates some powers of decision making to them. According to this theory, separation of ownership and control of a company leads to a divergence of interests between managers and shareholders.

The agency theory does not displace the importance of other stakeholders but emphasizes the shareholders as those majorly affected by the actions of the managers.
The relationship between corporate governance mechanisms and earnings management on a basis of agency theory has been variously addressed by authors. Also, agency theory stipulates that board with a majority of external directors will better oversee the management and reduce the likelihood of earnings management.

Empirical framework (Board Size and Earnings Management)

Board size is seen to be a very important part of the ability of boards to effectively oversee the affairs of the management as well as monitor their actions. A reasonable size of the board should be effective in monitoring the activities of firms' management. The Nigerian code on corporate governance states that the board should be of a sufficient size relative to the scale and complexity of the company's operations with a minimum membership of five. However, there is not yet any consensus about the optimal size composing board structure (Kouki, Elkhaldi, Atri, and Souid

2011). A larger board size results in higher reduction of managerial opportunistic discretion and more feasible decision making.

However, other researchers argue that a large board size is also attributed to higher degree of bureaucracy, in coordination, and ultimately slower decision making process. It has been suggested that the board which consists of more than seven or eight members is less likely to effectively work but a board with small size can perform more effectively. Agrawal and Cooper (2016) conducted a study that concluded with findings consistent with this viewpoint when proving that management turnover is negatively related to board size after accounting scandals.

Nahandi, Baghbani and Bolouri, (2011)examined the influence of the board size on earnings management in Iranian companies using a panel of 480 observations from 2001 to 2008 in Iranian companies and did not get any statistically significant relationship between board size with earnings management. Nugroho and Eko (2012) also discovered that board size do not affect earnings management of firms listed on the Indonesian stock exchange. This shows that previous studies relating to board size and earnings management relatively vary in their final outcomes. The code of corporate governance states that the board should comprise of a mixture of executive and non-executive directors with the majority being non-executive. According to OECD report, (IFC, 2010) the executive directors are the people directly involved with the management of the entire firm. Non-executive directors are appointed on the board mainly to obtain independent monitoring mechanism over the board process thereby reducing agency conflicts and improve performance. Kent, Routledge and Stewart, (2010) assert that higher degree of board independence creates obstacles for managers to engage in earnings manipulation according to their study of 392 listed Australian companies between the years 2000 to 2006.According to another study carried out by Gonzalez and Meca, (2014) on 435 listed firms in Latin American Markets from 2006 to 2009, they confirmed that the increased degree of board independence diminishes the likelihood of earnings management. However, it is also argued that independent directors perform little role in monitoring the board because they lack real independence, time, and adequate information.

Methodology The target population of this research consists of all Fast Moving Consumer Goods firms in Nigeria listed on the Nigerian Stock Exchange that have accessible financial reports for the period under review, numbering fifteen. See Appendix I.
This research made use of non-probability sampling technique and judgmental sampling method. Judgmental sampling method was adopted in selecting the sample as the criteria for choosing the companies was based on the availability of complete financial reports that contain the required information for the research model. The focus of this research would be on fifteen listed fast Moving Consumer Goods firms for the period, 2012 to 2015.

Measurement of Variables

Table 1: Description and definition of variables

Variables	**Measurement**	**Used by**	**A priori expectation**
Earnings Management (DAC)	Measured by absolute value of discretionary accruals using modified Jones model by Dechow *et al.* (1995)	Goncharov (2005); Chtourou *et al.,* (2001); Bala & Kumai (2015)	
Board Size (BS)	Measured as the total number of board members	Xie, *et al.,* (2002); Peasnell *et al.,* (2001); Fama & Jensen (1983)	A positive relationship

Source: Researchers' computation, 2019

Model Specification

In order To explain the relationship, a linear regression model equation was used.:
$Y= \beta_{jt}+ \beta_{jt} X1+ \mu_{jt}$
$DACC= F (BS_{jt})$ .... (1)
X = Board Size Y= Earnings management (Discretionary accruals)
μ = Error term
β= Coefficient of board size
Equation (1) can be further defined as
Earnings management = F (Board size) + μ .... (2)
The dependent variables are the earnings of the selected firms. The study employed the Modified Jones 1995 model.
The independent variable for this research is board size.

Control Variable

Firm size is considered an influential factor which is related to earnings management. It is primarily defined as natural logarithm of book value of the firm's total assets at the end of the year (Guthrie & Sokolowsky, 2010). The inclusion of this control variable is to protect the model from the biased effects of unobserved heterogeneity, improving the statistical power of the test (Nguyen, 2016).

Descriptive Analysis

Table 3:Summary of four years means and standard deviation for the variable

Variable	**Obs**	**Mean**	**Std. Dev.**	**Min**	**Max**
FMCG	60	5.43656	3.799389	.4051202	13.47925
BS	60	9.816667	2.473532	6	15

Source: Researchers' computation, 2019

This table shows a summary of the descriptive statistics of both the dependent and independent variables for the selected consumer product firms stating the average of the variables, the standard deviation, the minimum and maximum of variables used.
The absolute value of discretionary accruals of the listed FMCG firms in Nigeria (based on the modified Jones model) has a minimum value of 0.405, (which is close to 1) and a maximum of 13.479. The magnitude of absolute value of discretionary accruals in the sample firms has a mean of 5.436 with standard deviation of 3.799. This shows that on average the sample-firms engage in upwards earnings management indicating that the deviation between the sample companies is quite large. The discretionary accrual values are above zero, which suggests the existence of Earnings Management in the listed consumer product firms in Nigeria. This result implies that on the average the sampled firms engaged in upward earnings management when they meet or beat current earnings targets, repurchase shares in the following period, are larger in size, and have greater insider purchases in the following period unlike firms who engage in downward earnings management to createreducing earnings to lower stock prices prior to granting stock options prior to repurchasing stock on the open market (Uwuigbe, Uwuigbe & Okorie, 2015). Board size (BS) is measured by the number of members on the board of each sample firm. In the samples, the mean value for board size is 9.816, with a maximum value of 15 members and a minimum value of 6 members. This indicates that the sample firms have an average of approximately 10 directors on each board.

Table 4: Pearson Correlation Matrix

	DACC	**BS**
DACC	1.0000	
BS	-0.1355	1.0000

Source: Researchers' computation, 2019
DACC = Discretionary Accruals

Regression Analysis

Table 5: Ordinary Least Square Regression Analysis

Source	SS	df	MS
Model	401.284855	6	66.8808092
Residual	450.40137	53	8.49813905
Total	851.686225	59	14.4353597

Number of obs	=	60
F(6, 53)	=	7.87
Prob > F	=	0.0000
R-squared	=	0.4712
Adj R-squared	=	0.4113
Root MSE	=	2.9152

DACC	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
BS	.3889951	.210659	1.85	0.070	-.0335334	.8115235
BM	1.227109	.4095176	3.00	0.004	.4057206	2.048497
BI	2.311355	1.601922	1.44	0.155	-.9016934	5.524404
BFE	-1.283151	1.394392	-0.92	0.362	-4.079947	1.513644
MC	-.8875122	1.144119	-0.78	0.441	-3.182325	1.407301
FSIZE	-1.216314	.2903681	-4.19	0.000	-1.798719	-.6339097
_cons	15.78107	4.758864	3.32	0.002	6.236	25.32614

Researchers' computation, 2019
Note: Please isolate all other variables. Only Board Size (BS) is relevant here.

Test of Hypothesis

The following hypothesis was tested to ascertain the relationship between board size and earnings management of the selected firms.
H_0: There is no significant relationship between the board size and earnings management of the listed Fast Moving Consumer Goods firms in Nigeria.
From analysis on Table 5, the P>|t| (Prob) value for board size is 0.070. This indicates that there is a significant relationship between board size and earnings management in consumer product firms. This is because the Prob value, P>|t| for BS is positive and significant at 10%. Although the correlation analysis shows a weak negatively significant relationship, the regression analysis reveals that the relationship though significant, is positively related. Hence the researcher accepts the hypothesis that the size of the board is significantly related to earnings management in consumer product firms. The reason for rejecting the null hypothesis is that the P calculated-value is less than 0.10; also the slope of the co-efficient is positive at 0.3889951. This means that BS is significantly positively related to earnings management. This means that an increase in board size will lead to an increase in earnings management. Agrawal and Cooper (2016) conducted a study which concluded with findings consistent with the viewpoint that management turnover is negatively related to board size after accounting scandals. A larger board size results in higher reduction of managerial opportunistic discretion and more feasible decision making.

CONCLUSION

From the analysis and interpretation, it can be concluded that there exists overall significant relationship between the board size and earnings management. A firm with small board size is capable of constraining the earnings management practices of the managers of FMCG firms in Nigeria. This is because board size has been found to be positively significant to earnings management in the FMCG sector of the economy of Nigeria between 2012 and 2015. Potential and current investors should look beyond the earnings and corporate growth of the firms in this industry to the corporate governance practices considering the size of the board so as to be protected from managers' manipulations and opportunistic discretions.

RECOMMENDATION

In view of the analyses carried out, it is hereby recommended that:
Board size should be reduced so as to reduce managerial manipulations. This means that the shareholders and other board members should consciously limit the number of board members appointed at every period.

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APPENDIX I

Companies	Company Identifier	Fiscal year	DACC	z
NESTLE	1001	2012	5.00894	8
	1001	2013	1.765262	8
	1001	2014	2.096916	8
	1001	2015	1.83345	8
7UP	1002	2012	2.263921	9
	1002	2013	2.765768	9
	1002	2014	9.180772	9
	1002	2015	0.4051202	9
PZ	1003	2012	6.94056	12
	1003	2013	4.054308	12
	1003	2014	1.122913	12
	1003	2015	0.7455894	12
GUINNESS	1004	2012	3.447578	12
	1004	2013	3.79	12
	1004	2014	9.761098	12
	1004	2015	1.009887	12
NASCO BUSCUITS	1005	2012	10.36767	9
	1005	2013	7.712864	9
	1005	2014	4.823503	9
	1005	2015	10.36767	10
UNION DICON SALT	1006	2012	10.36767	6
	1006	2013	13.47925	6
	1006	2014	13.47925	8
	1006	2015	13.47925	8
INTERNATIONAL BREWERIES	1007	2012	10.36767	9
	1007	2013	7.465697	9
	1007	2014	3.907377	9
	1007	2015	3.632934	9
CHAMPION BREWERIES	1008	2012	5.886559	9
	1008	2013	7.680341	9
	1008	2014	9.411077	11
	1008	2015	5.394837	9
NIGERIA FLOUR MILLS	1009	2012	1.767986	15
	1009	2013	0.4275495	15
	1009	2014	2.982039	15
	1009	2015	13.47925	15

NIGERIAN BREWERIES	1010	2012	0.4290943	13
	1010	2013	3.880579	13
	1010	2014	7.824422	15
	1010	2015	5.438764	15
DANGSUGAR	1011	2012	3.996931	9
	1011	2013	11.11086	9
	1011	2014	8.604878	10
	1011	2015	4.085354	9
UNILEVER	1012	2012	1.144817	7
	1012	2013	2.10645	8
	1012	2014	4.780866	8
	1012	2015	0.9328676	8
HONEYWELL FLOUR	1013	2012	8.777521	9
	1013	2013	7.274119	9
	1013	2014	5.380821	9
	1013	2015	3.439806	14
CADBURY	1014	2012	3.440378	7
	1014	2013	3.253465	7
	1014	2014	4.932209	7
	1014	2015	1.371315	7
VITAFOAM	1015	2012	9.483543	8
	1015	2013	8.708616	8
	1015	2014	1.534557	9
	1015	2015	1.58885	8

DACC = Discretionary Accruals