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Corporate Governance and Earnings Management of Listed Non-Financial Companies in Nigeria

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Abstract
This study determined the effect of Corporate Governance (CG) on discretionary earnings management of non-financial companies listed on the Nigerian stock exchange. The study used ex-post facto research design using secondary data extracted from financial statement and accounts of the non-financial companies for eight years (2013-2020). Secondary data was analyzed using Arellano-Bover/Blundell-Bond Estimation technique; the results revealed that board size and board meetings have a negative and significant effect on current discretionary accruals, however, the results revealed that board independence have no significant influence on current discretionary accruals. The study concludes that board size and board meeting have significant effect on discretionary accrual earnings management of listed non-financial companies in Nigeria. Hence good corporate governance is necessary for maximization of shareholders' wealth the study therefore recommends strict compliance to the requirements of the Securities and Exchange Commission code of CG on the size of the board and the frequency of board meetings in Nigeria.
Keywords: Corporate Governance, Discretionary Accruals, Non-Financial Companies
JEL Classification Codes: G34, M42, H32

1. Introduction

Earnings management is embedded in many firms' cultures because it allows agents to use accounting choices and report profit consistently. Managers are expected to protect their fiduciary duties and provide benefits to all stakeholders. Hence, separation between ownership and control (agency conflict) in the modern and rapidly changing business world made a system of corporate governance necessary through which management are monitored and supervised to reduce the agency conflicts and align the interest of managers with that of the shareholders (Lin & Hwang, 2010). The principles of good corporate governance practices is one of the core values in creating value for shareholder while ensuring that behavior is not only ethical and legal but also transparent; therefore corporate governance is not an end but a means of value creation for all stakeholders (Kurawa & Ishaku 2014). The aim is to create an enabling environment where trust and confidence is guaranteed amongst those having a conflicting interest.

Full commitment is expected from the board of directors to achieve not only strategic objectives but also achieve sustainable long-term goals for the organization, and good governance plays a vital role to ensure consistency and rigour in making strategic decisions to ensure organization survival and maximization of value for all shareholder; hence, board of directors plays an important role not only in the strategy development and implementation but also in monitoring the management actions and inactions. In discharging this role, non-executive members of the board are in a position to challenge the proposal of executive directors', their decisions and highlight bad practices or poor performance.

However, Corporate Governance (CG) and earning management anomalies in Nigeria include the issues raised in Cadbury Nigeria Plc in 2006 and African Petroleum Plc which metamorphosed to Forte oil plc and (now Ardova PLC) where a 24 billion naira credit facility was completely omitted in the financial statements. Hence, it becomes very necessary to determine the link between CG and discretionary earnings management with emphasis on factors influencing earnings management to reduce agency conflict. Because of this, the present study answers the question how CG affects discretionary earnings management of non-financial companies listed in Nigeria. As such, this study determined the effect of CG on discretionary earnings management of non financial companies listed in Nigeria.

2. Literature Review

2.1 Conceptual Review

2.1.1 Concept of Corporate Governance

As a crucial issue, corporate governance has been widely addressed by regulatory authorities and capital market operators the world over. It is defined as the system and structures by which corporate organizations are directed, managed and controlled; it is all about monitoring and controlling corporate and strategic management decisions to ensure the achievement of the overall aim of the organization (Cadbury Report, 1992).

The Basel Committee (1998) considered CG from a banking perspective, as to how banking business are governed by the board of directors and senior management to manage a system in which the bank's objectives of mobilizing deposit and providing credit to the deficit segment of the economy are efficiently achieved and monitor performance. As such a firm is efficiently managed with transparency, due diligence and accountability to create value shareholders' are said to have adhered to corporate governance rules (Shleifer & Vishny, 1997); Pandy, 2005).

However, Organization for Economic Co-operation and Development [OECD], (2015) posited that CG being a system that explained how businesses are managed and controlled in the interest of all stakeholders shows a structures which specify the rights and responsibilities of all participants that is the strategic board representing absentee equity-holders, the management, other group of stakeholders and clearly spell out the procedures, process and rules for making a rational decisions on organizational activities. Hence, corporate governance can be define as a system which provides a robust structure for setting organizational goals and objectives and the means of attaining the goals and objectives in the interest of all stakeholders.

2.1.2 Concept of Earnings Management

Rahman, Muniruzzaman and Sharif (2013) defined earnings management as the deliberate restatement of accounting earnings using choice of accounting methods by either recognizing fictitious expenses, understating revenue or overstating business expenses to influence both short-term and medium-term accounting earnings. Omoye and Eriki (2014) defined discretionary-earnings management as an attempt by corporate managers to restate accounting figures by applying different accounting methods or accelerate business revenue using different accounting methods purposely to influence short-term business income. According to Barton, Hodder and Shepardson (2014) it is predominantly a functions of significantly restating or adjusting discretionary accruals (Barton, Hodder & Shepardson 2014). It is equally defined as the active restatement and manipulation of accounting figures' to present unrealistic performances of an organization (Mulford & Comiskey, 2012). Similarly, Ishaku, *et al.*, (2019) defined it as the mis-use of management discretionary power to structured transactions just to influence stakeholders' decisions. Hence, it is defined in this study as the deliberate restructuring of business transactions to present a business performance that is not in tandem with reality.

2.3 Empirical Review

A lot has been written on CG mechanisms and discretionary earnings manipulation for example Jaggiab, Leungc and Gulde (2009) using firms in Hong Kong documented a significant influence of boards of directors' independence in minimizing discretionary earnings management. This proved that board independence played essential role in ensuring high-quality financial reporting. Hence, firms in Hong Kong should ensure the appointment of independent directors since they played an essential role in ensuring high-quality financial reporting.

Habbash (2011) investigated the relationship between CG mechanisms and discretionary earnings management of Saudi Arabian firms. The study covered a period of four years (2006-2009) and the findings confirmed that board size and board independence have a negative and significant effect on discretionary earnings management. On the contrary, Lee, Ku and Chen (2012) study explored the interface between CG and discretionary earnings restatement of 268 companies in Taiwan using a modified Jones model. Regression analysis was used and the findings confirmed a positive and significant interface between discretionary accruals and free cash flow. Companies audited by the Big-four report lower discretionary accrual compared to companies audited by non-big four. However, the results further showed that corporate governance factors are not significantly related with discretionary accrual.

However, Mansor, *et al.,* (2013) study used a sample of 264 listed companies and examine the effect of CG on earnings management. Data were analyzed using regressions analysis; the findings revealed that CG mechanisms significantly influence earnings manipulation (EM) of companies owned by family members (FOC) and the companies owned by non-family members (NFOC). At the same time, Ugbede, Lizam and Kaseri (2013) examined the effect of corporate governance in minimizing earnings restatement of bank in Nigeria and Malaysia using modified Jones model. The study covered 2007- 2011. Findings revealed that corporate governance is negatively related with earnings restatement.

Similarly, Patrick, Paulinus and Nympha (2015) determined the effect of corporate governance mechanisms on earnings management practices of quoted companies in Nigeria using primary and secondary data for the period 2011-2014. Simple regression analysis was used for data analysis and the findings revealed that corporate governance mechanisms (board size, board independence, audit committee strength and firm size have significant influence on earnings adjustment practices of companies in Nigeria. Hence regulatory guidelines lines on the size of the board and independence should be adhered to.

Nkanbia-Davies, *et al.,* (2016) examined the effect of CG on the quality of earnings in banks operating in Rivers State. Data were analysed using regressions technique; the findings confirmed that size of the board and independent directors have significant impact on accrual quality. In contrast, Chelogoi (2017) determined the effect of corporate governance on earnings management of 60 companies in Nairobi for eight years (2005-2012). The secondary data was analyzed with inferential statistics. The findings revealed that CEO Duality and board independence are negatively and significantly related with earning adjustments. Then companies should ensure that the position of chairman and CEO and handle by different persons since CEO Duality influence earnings adjustment.

Manukaji (2018) examined the effect of CG mechanisms on income smoothing of DMBs in Nigeria. Secondary data for the period 2012 to 2016 was used and income smoothing was determined using index. The multiple results revealed that CG mechanisms (CEO duality, ownership concentration, and audit committee presence) have significant influence on income smoothing of DMBs in Nigeria. Management should comply with regulatory issues on ownership concentration strictly.

Similarly, Adegbie, Salawu, and Shiyanbola (2019) examined the relationship between CG and earnings quality of 30 listed Nigerian financial and non-financial companies. Multiple regression analysis was used analyzing the data for the period 2003-2017 and found a significant interface between corporate governance and the quality of earnings.

However, Kuma, Abraham and Terpase (2019) using information and communication technology companies and down-stream oil companies in Nigeria uncovered a negative though insignificant interface between board composition and cash based earnings manipulations.

2.4 Theoretical Framework

Agency theory is considered relevant in minimizing agency conflict since the absentee owners may not have access to all business information at the time a decision is taken by the managers because of the inability to assess and confirmed that manager’s action and inactions are truly in the interest of the firm. Xie, Davidson and DaDalt (2003) also assert that conflict of interest existing between absentee shareholders and their agents is detrimental to users of accounting information in consideration of signaling effect. Hence, the need to reduce the conflict of interest owners and managers to achieve optimality cannot be underestimated. As such high compliance to good business practice and code of CG is highly necessary to ensure organizational survival and protect the interest of diverse stakeholders. As such the current study is explained by agency theory hence it was adopted to guide this study.

3. Methodology

An ex-post facto research design was adopted because data were extracted from the annual financial statement and accounts of the non-financial firms listed in Nigeria. However, twenty-eight companies are selected using two criteria. Each company must be quoted throughout the period 2013 -2021, and the relevant data must be disclosed in the annual statement of the firm, the companies that met these criteria are contained in appendix one. Panel GMM analysis (Arellano-Bover/Blundell-Bond Estimation technique) was used in analyzing the data, the use of panel GMM analysis is because the data are micro-panel in nature and the number of companies (28) is more than the time period (8 years) under study.

Table 1: Variables and their Measurements

Variables	**Type**	**Measurements**	**Sources**
Discretionary Accruals (DA)	Dependent	Total accrual minus Non-discretionary accrual	Habbash (2011) Mansor, *et al.,* (2013)
Board size	Independent	Total sitting members on the board	SEC (2011); Uwuigbe *et al.,* (2014); Nkanbia-Davies *et al.,* (2016)
Board Independence	Independent	Independent non-executive directors divided by total directors	Nazir and Afza (2018); Kuma *et al.,* (2019); Adegbie *et al.,* (2019)
Board meetings	Independent	Number of meetings held by the board of directors	Adegbie *et al.,* (2019)
Size of the Firm (Fsize)	Control	Log of assets	Adegbie *et al.,* (2019)
Ratio of Cash Flow to Asset (NCFTA)	Control	Current sales – previous sales divided by total sales	Ishaku *et al.,* (2019)
Returns on Assets (ROA)	Control	Profit before tax / total assets	Ishaku *et al.,* (2019)

Source: Authors' Compilation, 2023.

3.1 Model Specification

Earnings management is the DV and is proxy using discretionary accrual (DA), corporate governance (BS, BI and BMT) represent independent variables while firm size, return on asset and net cash flow to assets are used as control variables. However, the models used in the studies of Adegbie *et al.,* (2019); Kuma *et al.,* (2019) were adopted with little modifications.

Thus the model is as follows:

$$DA = f(BS, BI, BMT, FSIZE, NCFTA, ROA)........................1$$

$$DA_{it} = \alpha + \beta_1 BS_{it} + \beta_2 BI_{it} + \beta_3 BMT_{it} + \beta_4 FSIZE_{it} + \beta_5 NCFTA_{it} + \beta_6 ROA_{it} + \varepsilon_{it}.....2$$

4. Results and Discussion

The data analysis including descriptive statistics, correlation and Arellano-Bover/Blundell-Bond estimation results are presented in the table 2.

Table 2: Descriptive Statistics of the Variables

Variable |	Obs	Mean	Std. Dev.	Min	Max
dacc |	168	0.608	4.168	-15.163	50.521
bsize |	168	9.679	2.814	5	17
bi |	168	0.739	0.119	0.462	0.929
bmeeting |	168	3.881	0.359	3	5
fsize |	168	10.189	0.824	8.419	11.809
ncftta |	168	0.133	0.209	-0.329	1.403
roa |	168	0.095	0.174	-0.287	0.869

Source: STATA Output

Table 2 revealed a mean of 0.608 for discretionary accruals, a minimum of -15.163 and a maximum of 50.521, standard deviation of 4.168 shows variation in management of earnings by these companies. Size of the board shows an average of 9.679, a minimum, maximum and standard deviation of 5, 17 and 2.814 respectively. However, standard deviation of 2.814 shows no significant deviation in the companies' board size. The results revealed a mean of 0.739 for Board independence, meaning approximately 74% of board membership of listed non-financial companies are independent and non-executive directors, minimum of 0.426 and maximum of 0.929 meaning there are companies with 93% non-executive directors in the board. However, standard deviation of 0.119 shows no significant variation on board independence within the period understudy.

On average the firm size under study is 10.189, a minimum of 8.419 and maximum of 11.809, the standard deviation of 0.824 confirmed no deviation in the size of the companies for the period considered. The ratio of cash flow to total assets shows 0.133 mean, a minimum, maximum and standard deviation of -0.329, 1.403 and 0.209 respectively, however, standard deviation of 0.209 confirmed significant deviation in the net cash flow of the period covered. The mean for ROA is 0.095 meaning the companies under study generated 9.5% returns on asset invested, the minimum, maximum and standard deviation of -0.287, 0.869 and 0.174

respectively justify no significant variation on ROA of companies under study.

Table 3: Correlation Matrix

Variable |	dacc	bsize	bi	bmeeting	fsize	ncftta	roa
dacc |	1.000						
bsize |	0.059	1.000					
bi |	0.029	-0.103	1.000				
bmeeting |	0.053	0.187	0.106	1.000			
fsize |	-0.006	0.553	0.006	0.115	1.000		
ncftta |	0.513	0.027	0.109	-0.022	0.0004	1.000	
roa |	0.176	0.086	-0.011	-0.062	0.039	0.453	1.000

Source: STATA Output

Table 3 shows that only firm size is negatively correlated with discretionary accruals other explanatory variables are positively correlated with discretionary accruals (DA). The implication of this to our chosen estimation technique is that management may be prone to use their discretion judgement to manipulate earnings using total assets.

Table 4: Results of System-Dynamic Panel-Data

Variables	**Expected sign**	**Coefficient**	**P-Value**
DA_{t-1}		-0.076	0.000***
bsize	(-)	-0.161	0.028**
bi	(-)	0.451	0.768
bmeeting	(-)	0.471	0.068*
fsize	(-)	0.694	0.014**
ncftta	(-)	6.935	0.000 ***
roa		0.458	0.604
CONS		6.009	0.034**
Number of Observation	140		
P-value	0.000		
Number of Companies	28		
Chi2	250.96		
Arrelano-Bond AR(2) Test	-1.8124	0.0699	
Sargan Test	10.675	0.6380	

Source: STATA Output

Table 4 shows the System Dynamic Panel Data regression results. Instruments validity and result of reliability revealed by Sargan test and Arrelano Bond serial correlation AR(2) revealed absence of serial correlation at second order, no auto correlation and no over-identifying instruments. Lagged Discretionary-Accruals (DA_{t-1}) coefficients show a significant negative influence on the present discretionary manipulations justifying that lagged discretionary accrual have a significant influence on present discretionary accruals (DA_t).

The result revealed a negative and significant impact of size of the board on discretionary accruals. This implies that lager board significantly influence management decisions to reduce their discretionary power. This is consistent with findings of Habbash (2011) whose findings confirmed a negative and significant interface between size of the board and management discretionary power. It is however, contrary to the findings of Kuma *et al.*, (2019) whose findings uncovered a positive but not significant association between size of the board and earnings manipulations.

Board independence showed a positive but not significant influence on present discretionary manipulation. It is in line with Chelogoi (2017) who uncovered no significant interface between the independence of a board and earning manipulation, this is also in tandem with Kuma *et al.*, (2019) whose findings revealed a negative but insignificant relationship between composition of the board and cash-based earnings manipulations.

However, the findings contradict Omoye and Eriki (2014) results that provide evidence of a significant effect of board independence on discretionary earnings adjustment. Board meeting has significant influence on current discretionary accruals, the outcome further showed that size of the firm and ratio of net cash flow to assets have significant influence on earnings adjustment, this is in equally in line with the previous findings of Omoye and Eriki (2014). However, returns on assets have positive but not significant current discretionary accruals.

5. Conclusion and Recommendations

This study determined the effect of corporate governance on discretionary earnings adjustment and based on the empirical findings, it is concluded that board size and board meeting have significant effect on earnings management of non-financial companies listed in Nigeria. Hence good corporate governance is necessary for maximization of shareholders' wealth. The study therefore recommends strict compliance to the requirements of the SEC 2011 code of CG on not only the composition and size of the board but also the frequency of board meetings in Nigeria. Hence, meetings of the board should be attended by all directors for robust discussion before decision is made. In addition, the board should be encouraged to nominate more independent directors to ensure independence of the board since independent directors can challenge the discretionary decision of managers' and hence reduce their discretionary power to manipulate accounting estimates.

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