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Corporate Governance on Earnings Management in Listed Deposit Money Bank in Nigeria

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ABSTRACT

The increase in the manipulation of accounting records and collapse of some Nigerian Deposit Money Banks have left question in the mind of researchers on the role of corporate governance. This paper was carried out to examine the impact of corporate governance attributes on earnings management of listed Deposit Money Banks from 2009 to 2017. The study used a sample size of thirteen (13) banks. The dependent variable was measured using Discretionary Loan Loss Provision Model by Chang, Shen and Fang (2008). Correlational design was employed; the secondary data was obtained from the annual reports of the firms and Nigerian Stock Exchange website. The results from the multiple regression analysis proved that board size has positive and significant impact on earnings management; board independence has negative and significant impact on earnings management while board of directors' ownership has insignificant impact on earnings management. The study concludes that effective monitoring role of independence directors will constrain the opportunistic behavior by managers. The paper therefore recommends among others that banks should increase the numbers of independent directors on the board to improve their monitoring effectiveness.

KEYWORDS: *Discretionary loan loss provision, corporate governance, board size, board independence, board ownership*

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INTRODUCTION

The main aim of financial reporting is to bring to light firms' financial information to both internal and external stakeholders in a reliable and timely manner. An important element of financial report is earnings which serve as a tool for decision making by users of accounting information. Earning is seen as one of the key measures of financial performance of a firm which investors rely on when making investment decisions (Dichev, Graham, Campbell, Harvey & Rajgopa, 2013).

The financial report of firms is the medium through which Management renders stewardship to these stakeholders about their activities towards meeting these goals. Literatures (e.g., Mellado & Saona, 2018 and Mahboub, 2017) have shown that reports which ordinarily should provide a fair view of the firm's performance and financial status as at the reporting date have over the years and across the world been manipulated (Rahman & Abdullah, 2005).The activities of managers are mostly unobservable and the goals of the managers and their shareholders are not necessarily aligned. Managers deliberately manage earnings to maximize their utility at the expense of other stakeholders.

Earnings loose its credibility and reliability when managers use their discretions to manipulate accounting figures. Earnings management occurs when managers utilizes their judgments in preparation of financial report and in arranging their transactions to alter the financial reports to either mislead some stakeholders about the underlying economic performance of the firm or to affect contractual outcomes that rest on reported accounting numbers (Healy & Wahlen, 1999).

The role of corporate governance on earnings management has continued to receive attention from regulators, shareholders, literatures etc. Corporate governance is concerned with instituting mechanisms that safeguard firms' resources which are optimally employed for the benefit of shareholders (Sanyaolu & Job-Olatunji, 2017). The separation of ownership and control indicated the need for mechanisms to monitor and control management actions. The main mechanism used to protect stakeholders against misleading or even fraudulent financial assertions is the corporate governance structure. (Mather & Ramsay,2016). This structure comprises the board of directors, board committees and the internal audit function.

Corporate governance at the level of the boards of directors and audit committee influences the quality of financial reporting which in turn influences investors' confidence consequently the management tend to have minimal cash flow diversion, reduced agency issues

In Nigeria, the responses to continuous call for strengthening corporate governance mechanisms led to the promulgated code of corporate governance in 2003 by the Nigeria Stock Exchange (NSE) and Central bank of Nigeria (CBN). In 2005, 2008 and 2011 new corporate governance codes emerged in order to improve the effectiveness of the board. Recently, Financial Reporting Council of Nigeria (FRCN) promulgated another code of corporate governance in 2018 which seeks to establish corporate governance best practices and encourage public awareness of important corporate values and ethical practices that will improve the integrity of the business environment (Ojeshina & Adelupe, 2019). The corporate governance codes further aim to protect the investors from unscrupulous management of listed firms in Nigeria.

Deposit Money Banks play a very vital part in the development of any nation economy, and their financial failure could prompt unpleasant costs to depositors and other stakeholders. According to a report in (This Day, 2019) the adoption and enforcement of corporate governance culture will help eradicate fraud, poor management and insider abuses by manager and board members. This is an indication that good corporate governance practices are essential for improvement in Nigeria financial sectors.

Review of Literature

Earnings management

Different definitions exist for the concept of earnings management, some relating to opportunistic behavior and the other informational goal (Mahjoub & Miloudi, 2015). According to Davidson, Stickney and Weil (1988), earnings management is the process of taking intentional steps within the limitations of generally accepted accounting principles to achieve a desire profit target. Also, (Wu, 2014) opined that earnings management occurs through manipulations in accounting elements in the income statements and statement of financial position that may align with the law but may mislead some stakeholders. These definitions suggest that managers take advantage of loopholes in standard and law to manipulate accountings figures.

With respect to informational perspective, the earnings management is seen as signal to market about firms' future performance (Altamuro, Beatty & Weber, 2005). In line with this, (Mahjoub & Miloudi, 2015) defines earnings management as any decision of reasonable, lawful and appropriate management that offers value to stakeholders.

Corporate governance

Various definitions exist on what constitute corporate governance. According to OECD (2004) corporate governance is defined as "*a set of relationships between a company's board, its shareholders and other stakeholders*". This definition captures corporate governance as an interwove between board members, shareowners and others stakeholders. Solomon and Solomon (2004) referred corporate governance as the system of checks and balances, both internal and external to firms , which ensures that firms perform their accountability function to all their stakeholders and act in a socially responsible way in all areas of their business activity" this definition broaden corporate governance by extending corporate social responsibility need. it is also referred as a mechanism for managing, directing and supervising the actions of the firms with the goal of creating value for shareholders (Zain-aldini, 2011)

Theoretical Framework

Agency theory

The agency theory explains the relationship between the principals (shareholders) and the agent (managers). This agency theory argues that due to the separation of ownership and control in an organization, rational managers are less likely to always work in the interests of owners (Jensen and Meckling, 1976). To reduce issue of managerial interests, shareholders will have to establish internal corporate governance mechanisms to monitor managers and the agents (Jensen and Meckling, 1976)

One of the top internal corporate governance mechanism used to reduce agency issues is the board of directors (Fama & Jensen, 1983). Boards play an important role in censuring that agency problem is curtailed. The board of directors monitoring of top management and establish different mechanisms (committees) in order to mitigate managers incentives to act opportunistically (Mather & Ramsey, 2003).

Also agency theory also argues that board independence is an effective monitoring mechanism that can be used to control manager's engagement in earnings management behavior (Alves, 2011). In another dimension, agency theory argue that when managers are allow to have an stake in the of shares of the firms, it can make them to align their interests with other shareholders that can led to less discretionary behavior ((Mehran, 1995).

Empirical review and Hypothesis Development

Board Size

Boards of directors exist to monitor the activities of the management as agency theory suggests, the separation of ownership from the management has resulted to conflict (Jensen & Meckling, 1976). The boards of directors are the number one mechanism in place to reduce the agency conflict (Boshkoska, 2015). According to Wang (2015), board of directors is a group of knowledgeable employee who strive together on behalf of shareholders to govern and protect the company.

With respect to board of directors, a study conducted by Liu (2011), on earnings management using a sample size of 93 firms listed in Shangai stock exchange from 2001 to 2009, discovered that board size has a positive impact on earnings management. The study confirmed that as larger board size increase the degree of earnings management in firms. Smaller board is more efficient in monitoring the management. On the contrary, Fathi (2013) examined the relationship between the quality of financial information disclosed and governance mechanisms for French companies listed on the SBF 250 for a period of five years from 2004 to 2008. The study revealed that board size has positive effect on quality of financial information. Larger board of directors improves the monitoring effectiveness of the board.

Also in Nigeria, Onuorah and Imene (2016) examine the correlation between corporate governance indicators and financial reporting quality. The study confirmed that the size of the board of directors has positive influence on the financial reporting quality on the firms.

Daghsni, Zouhayer and Mbarek (2016) empirically examined the effect of the board characteristics on the earnings management by using a sample of 70 French listed companies for the period of 4 years from 2008 to 2012, the study revealed that large boards are more effective in monitoring and controlling the CEO. In another dimension, Kapoor (2016) investigated the influence that corporate governance characteristics on the quality of financial information in Nordic countries (Finland, Sweden and Denmark) by using a sample of 62 firms for the period 2015. The study confirmed an insignificant relationship between the number of board directors and its discretionary accrual. They concluded that the size of the board has no influence on the quality of accounting information. This is also in line with Olaoye and Adewunmi (2016) who found board size to have negative and insignificant effect on the earnings management of the sampled firms.

Further in Nigeria, Ikumapayi, Uwalomwa, Uwuigbe, Ozordi, Oriabie, Asiriuwa (2018) in their paper evaluated the relationship corporate governance attributes on earnings management. The study used a sample of 44 across the eleven (11) sectors listed on Nigerian Stock Exchange. The study discovered that board size is positive significantly influencing the level of earnings management practiced in Nigeria. This further confirmed that smaller board size will be more effective in reducing opportunistic managerial behavior.

Al Azeez, Sukoharsono, Roekhudin and Andayani(2019) investigated whether the Board Characteristics have any impact on Earnings Management among the international Oil and Gas Corporation in the world. The study used a sample of 71 firms from the top 250 corporations for one year period (2016). The study found that board size does not have any impact on the reduction of earnings management. The study concluded that the larger the board size, the less efficient they are in monitoring the board.

The study hypothesized that board size has no significant influence on earnings management of listed deposit money banks in Nigeria.

Board independence

Board independence is considered be the most effective mechanism in monitoring and controlling the opportunistic behavior of managers. Chi-keung Man and Brossa Wong (2013) confirmed that board independence can improve monitoring behaviors in managers, including the misappropriation of assets. Kukah (2015) examined a study on corporate governance and earnings management using a sample of 20 non-financial institutions listed on the Ghana Stock Exchange for the period 2003 to 2013. The result confirmed that independent directors served as a constraint to the opportunistic behavior of the managers.

Also, Olaoye and Adewunmi (2016) examined the effect of corporate governance measures on earnings management of listed deposit money using a period of 2006 to 2015. The study revealed that the greater number of independent directors on the board inversely influence earnings management of the firms. Further, Akeju and Babatunde (2017) in their paper evaluated the impact of corporate governance and financial reporting quality using a sample of 40 firms listed on the Nigeria Stock Exchange (NSE) from 2006 to 2015. The evidence of the findings confirmed greater number of independent directors improves financial reporting quality.

Also, Enofe, Iyafekhe and Eniola (2017) in their investigation confirmed that board independence was negatively related to earnings management in Nigeria. On the contrary, Mahboub (2017) conducted a study in Lebanese banks using a sample of 22 banks for the period 2012 to 2015. The study found an insignificant association between board independence and quality of financial reporting. This finding confirmed that board independence cannot explain the financial reporting quality of the banks.

Ibrahim and Jehu (2018) carried out a study on the relationship between board composition and financial reporting quality in Nigeria Using a sample of 96 Nigerian firms from 2011 to 2016 The findings revealed that the proportions of the non-executive directors and independent non-executive directors has negative influence on abnormal accruals. On the contrary, Aifuwa and Embele (2019) in their paper found board independence to be insignificantly related to financial reporting quality in Nigeria.

The study hypothesized that board independence has no significant influence on earnings management of listed deposit money banks in Nigeria.

Board of director's ownership

Aygun, Ic and Sayim (2014) This study investigates the impact of corporate ownership structure on earnings management in Turkish firms for the period of 2009 to 2012. The managerial ownership was found to be positive and significantly influencing earnings management. Study by conducted by Gonza´lez and Garcı´a-Meca (2015) on listed Latin America non-financial firm was found an inverse relationship between inside ownership and earnings management.

In Nigeria, Erah and Ikhu-Omoregbe (2017) conducted a study on earnings management 178 non-financial firms in 2016.They findings confirmed that Chairman Ownership,, CEO ownership and Directors Ownership has positive influence on earnings management. Also, Obigbemi et al. (2017) conducted a study on ownership structure and earnings management in Nigeria firms using a sample of 137 firms In Nigeria , they found that the increase in management ownership increase the opportunity of earnings management in Nigeria. .

Also Mellado & Saona (2018) extend added to literature on Latin America Market, they discovered that increase insider ownership increases, managers engage in real earnings management. On the contrary Muath, Muiz and Fawzi (2018) examined the association between corporate governance mechanisms and disclosure quality for the companies listed in Palestine Exchange. The study confirmed that board ownership improve the disclosure quality.

The study hypothesized that board of director ownership has no significant influence on earnings management of listed deposit money banks in Nigeria.

Methodology

This study adopted ex post facto research design in examining the impact of corporate governance and earnings management. The population of the study is 16 listed deposit money banks in the Nigerian Stock Exchange (NSE) as at 31 December, 2017. The study used a sample of 13 listed deposit banks with exception to Skye bank, Jaiz bank and Eco transnational. The study used a secondary source of data which was obtained from the firm's Annual report and accounts from 2008 to 2017. The study employed a multiple regression technique as a technique of analysis with the aid of Stata 13.

Models specification

Earnings Management Model

This study adopts Discretionary Loan Loss Provision Model by Chang, Shen and Fang (2008) to measure the earnings management as used by Farouk and Isa (2018) etc.

The Discretionary Loan Loss Provision was chosen as it is specially built for financial sector (Chang et al. 2008). The model is shown below:

$LLP/Ta_{t-1it} = \alpha_0\ 1/TA_{it-1} + \alpha_1\ LCO_{it}/TA_{it-1} + \alpha_2\ BBAL_{it}/\ TA_{it-1} + \varepsilon_{it}$

where:

$DLLP_{it} = \varepsilon_{it} = LLP_{it} - (\alpha_0\ 1/\ TA_{it-1} + \alpha_1\ LCO_{it}/\ TA_{it-1} + \alpha_2\ BBAL_{it}/\ TA_{it-1})$

Where: *LLPit* = Loan Loss Provision for firm i at time t.
LCO = the Loan Charge-offs for firm i at time t.
BBAL = the Beginning Balance of LLP for firm i at time t.
TAit = the beginning Total Asset of firm i at time t.
e = the error term
α_0 = the intercept

The discretionary loan loss provision estimated from Chang et al. (2008) model was used in examining the impact of corporate governance attribute on earnings management.

DLLPit = β0 + β1BDSIZEit + β2BDINDit + β3BDOWNSit + β4FSIZEit + eit

Whereas:
DLLP = Discretionary loan loss provision (proxy for earnings management)
BDSIZE = Board Size
BDIND = Board Independence
BDOWNS = Board of Directors Ownership
FSIZE = Firm Size
ε_{it} = Error term
β0 = is the intercept
β1 – β4 = are the parameters to be estimated in the equation

Table 3.1 Variables Definition and Measurement

S/N	VARIABLES	DEFINITION	TYPE	MEASUREMENT	AUTHORS
1	DLLP	Earnings Management	Dependent	Absolute residual from discretionary loan loss provision	Chang et al. (2008)
2	BSIZE	Board size	Independent	The number of directors on the board	Al Azeez et al. (2019)
3	BIND	Board Independence	Independent	The proportion of independent directors on the board	Akeju and Babatunde (2017)
4	BDOWNS	Board Director ownership	Independent	The proportion of women directors on the board	Muath, Muiz and Fawzi (2018)
5	FSIZE	Firm size	Control	Log of total assets	

SOURCE: Researcher compiled 2019.

Results and Discussion

Summary of Descriptive statistics

Table 4.1: Descriptive Statistics of the Variables

Variables	NO OF OBS	MEAN	STD DEV	MIN	MAX
DLLP	117	.0324	0.0314	.00289	0.1975
BDSIZE	117	13.77	2.70	.8	20
BDIND	117	.1577	.0661	.05	.3
BDOWNS	117	.0680	.1069	.001	.3811
FSIZE	117	5.98	.4013	4.878	6.7264

Source: Descriptive Statistics Result using STATA 13.

Result from table 4.1 showed reveals that Discretionary loan loss provision has an average value of 3.2% and a standard deviation of 3.14% suggesting that the reported earnings management does not have much disparity across the sample banks. Also the mean value of the board of directors is approximately 14 suggesting that board sizes across the banks are similar in nature. Further the table reveals that the average value of the independent directors for the banks within the period of the study is 15.77%. This still account for a low number with relative to the board. The director's ownership reveals a mean value of 6.8% and a standard deviation of 19.69% indicating that there is a wide variation in the director ownership across the sample banks.

Post Estimation Test

The study conducted some post estimation test in line with the assumption of ordinary least square regression such as Normality of the residual, multicollinearity test. Also panel analysis and post estimation to test was carried out for decision making. Hausman specification test and Breusch and Pagan Lagrangian multiplier test for random effects was further conducted.

The study conducted normality as one of the assumptions of OLS regression and the result reveals a probability of 0.1140 which is insignificant. This implies that the residual is normally distributed.

Further the test relating to multicollinearity reveals variance inflation factor (VIF) for all the variable are less than 10 (Gujarati, 2004). This, further suggest that there is no multicollinearity among the independent variables.

Panel analysis was carried out and Hausman test reveals a coefficient of 2.11 and P-value of 0. 7147, which is in favor of random model. Further to determine the existence of panel effect the study carried out Breusch and Pagan Lagrangian multiplier test for random effects. The result revealed a chi square of 86.01 and Prob > chibar2 is 0.0000 indicating that there is a panel effect and random model is the ideal for the study, hence, the study interpreted the random effect model.

Regression Results

In this section, the regression results of corporate governance and earnings management are presented and analyzed.

Random Effect Regression Model

Variable	Coefficients	Std error	z-value	p-value
BDSIZE	.00326	.0010	2.98	0.003
BDIND	-.0742	.0369	-2.01	0.044
BDOWNS	.0153	.0355	0.43	0.665
FSIZE	-.0332	.00907	-3.66	0.000
CONSTANT	18.65	.0529	3.27	0.001
R2	0.2219			
f-statistic	18.65			
p-value	0.0009			

***, **significant at 5%, 1% .Source: REM regression result using STATA 13**

Interpretation

The random effect regression model deemed appropriate for the study revealed a chi square F-statistic of 18.65 and a p-value of 0.0009 which is significant indicating that the model is adequate and the variable have joint effect on earnings management. The R2 over all is 22.19% suggest that the corporate governance variables are able to explain change in discretionary loan loss at a percentage of 22.19%.

From the table above, board size has a coefficient of .00326 and p-value of 0.003. This suggests that size of the board of directors has a positive and significant impact on discretionary loan loss provision. The finding reveals that larger board size will increase the opportunistic action of managers. This is an indication that larger board is less effective in monitoring the managers of the deposit money banks in Nigeria. Thus the study reject the null hypothesis which states that board size has no significant impact on the earnings management of the listed deposit money banks in Nigeria. This finding is in conformity with the studies Ikumapayi et al. (2018)

Further table above revealed that board independence has a coefficient of -.074 and a probability value of 0.044 significant at 5% level of significance. This shows that increase in the percentage of the independent directors on the board will reduce earnings management. This implies that independence directors perform their monitoring and control function in Nigeria deposit money banks. These actions curtail the manager's engagement in earnings management. Thus the study reject the null hypothesis which states that board independence has no significant impact on the earnings management of the listed deposit money banks in Nigeria.

Further table above showed that board directors share ownership has a positive and insignificant influence on earnings management as reveals by the coefficient of 0153 and a p-value of 0.665. The finding implies that the shares held by the directors have no influence on management engagement in earnings management. Thus the study fails to reject the null hypothesis which states that board size has no significant impact on the earnings management of the listed deposit money banks in Nigeria.

Conclusions and recommendations

This study investigates the impact of corporate governance attribute on earnings management of listed deposit money banks in Nigeria from 2009 to 2017. The board size, board independence and board of directors share ownership constitute the corporate governance attribute while earnings management was derive from Chang et al. (2008). It was found that board size has a positive influence on earnings management of listed deposit money banks in Nigeria, board independence has negative and significant influence on earnings management and board of director ownership is positive and not significant. The result indicates that corporate governance attributes has significantly impact on the earnings management of listed deposit money banks in Nigeria. Based on this, the study concluded that larger board size is less effective in controlling earnings management practice in the deposit money banks. Also, independent directors play a great role in curtailing opportunistic behavior by the banks. The study recommends that regulatory authorities should ensure that each bank have a reasonable number of independent directors on the board as an average of 15.77% for the sample firms is less in ensuring earnings management is reduce in the sectors.

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