CORPORATE GOVERNANCE MECHANISMS AND EARNINGS QUALITY OF LISTED MANUFACTURING COMPANIES IN NIGERIA

BY

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BEING A THESIS SUBMITTED TO THE SCHOOL OF POSTGRADUATE STUDIES, AHMADU BELLO UNIVERSITY, ZARIA IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF SCIENCE (M.Sc) IN ACCOUNTING AND FINANCE.

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DECLARATION

I hereby declare that this thesis titled “Corporate Governance Mechanisms andEarnings Quality of ListedManufacturing Companies in Nigeria” was written by me in the Department of Accounting under the supervision of DrShehu Usman Hassan and Dr. Ahmad Bello. The information derived from the literature has been duly acknowledged in the text and a list of bibliography provided. No part of this thesis was previously presented for another Degree or Diploma at any University. I take the sole responsibility of all errors that may arise therein.

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CERTIFICATION

This thesis entitled " Corporate GovernanceMechanisms and Earnings Quality Of Listed Manufacturing CompaniesIn Nigeria'' written by Muhammed,HauwauDalhat meets the requirements governing the award of the degree of Masters of Science (M.Sc) in Accounting and Finance of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This thesis is dedicated to Almighty Allah, and my loving parents Prof. DalhatuMuhammed and Haj. Khadija Muhammad.

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Firstly, I will like to thank the Almighty Allah for His divine guidance and compassion for successfully making this rigorous but rewarding study, a success and reality.

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ABSTRACT

Corporate governance mechanisms are essential for establishing an attractive investment climate and an efficient capital market, butthe accounting ethics ofmanagers tend have tremendous affect on the quality of earnings and thus the investment climate is distorted. These motivated the researcher to investigate the relationship between some sets of corporate governance (CG) mechanisms and earnings quality (EQ) of listed manufacturing companies in Nigeria. Four null hypotheses were formulated in line with the objectives of the study to test the variables. Correlation research design and multiple regression were adopted as research design and technique of data analysis. The results indicate that the corporate governance proxies have a significant impact on earnings quality of Nigerian Manufacturing companies.This establishes the fact that corporate governance plays a significant role in checkmating the unethical behaviours of managers in the Nigerian manufacturing sector and thus improving the earnings quality. The study therefore, recommends that the proportion of independent directors'on the board should be increased. More institutional shareholders should be allowed to invest, and audit committee members should comprise of persons with high integrity and experience to ensure effective monitoring. Also, the quantum of shares held by managers should be minimized to reduce unethical practice.

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CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The financial scandals that sunk the once 'high profile' companies such as Enron, Worldcom and Xerox in the United States, Parmalat in Italy and many other big companies around the world confirmed that there was an opaqueness in financial reporting that had hitherto not been penetrated. Corporate Governance (CG) was then introduced to facilitate and stimulate the performance of firms by creating and maintaining the incentives to motivate insiders to maximize the firm's performance and serve as control mechanism. The CG limits insiders' abuse of power over corporate resources and provides the means to monitor behaviour of managers for accountability and giving protection to investors (Ahmed, 2006). However, it becomes glaring that the existing Corporate Governance mechanisms are inefficient as they fail to protect the owners' interest. Consequently, the Sarbanese-Oxley Act was introduced in 2002 in the U.S. with a view to improving Corporate Governance practices. Many other countries, both developed and developing, followed suit. The Nigerian Stock Exchange (NSE) was not left out in the struggle for a better CG. However, despite the various measures adopted by Security and Exchange Commission (SEC) to foster efficient Corporate Governance structure and restore investors' confidence, there are still cases of manipulation or abusive accounting which is unethical by managers (Shehu, 2012).

Accounting information is relevant to the extent that it is capable of influencing a decision maker by helping him to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations (Bushman, Cheng, Engel and Smith, 2004). In order for information to be relevant, it must be timely, and it must have predictive value or feedback value or both (Ahmad, 2006). Financial statements should always provide reliable information to assist users in decision making. The statements should disclose relevant, reliable, comparable and understandable information (Kamaruzaman, 2009). Reliability has to do with the quality of information which assures that information is reasonably free from error and bias and faithfully represents what it intend to represent. Financial statement of firms can never be completely free from bias, since economic phenomena presented in annual reports are frequently measured under conditions of uncertainty because many estimates and assumptions are included in the report (Shehu, 2011). Although complete lack of bias cannot be achieved, a certain level of accuracy is necessary for financial report to be decision useful (IASB, 2008). Therefore, it is important to examine the arguments provided for the different estimates and assumptions made in the annual report, if valid arguments are provided for the assumptions and estimates made, they are likely to represent the economic phenomena without bias (Jonas and Blanchet, 2000).

The need for a good Corporate Governance structure arose because of the seperation of ownerhip between a firm and its owners, which turns the firm into a nexus of relationship between it and all its stakeholders such as managers, employees, shareholders, creditors, government and all its stakeholders. The

seperation of ownership and control by the sophistication of the modern day business redefines the relationship that exists between the owners and the managers to that of an agent and a principal. Being the agent, the manager is expected not to pursue goals that are geared towards the achievement of his own interest at the expense of shareholders' wealth maximization. The existence of conflict of interest between managers and owners naturally compromises the value of the firm and only transparency can eliminate the conflict. For a company to be transparent, it should be able to disclose financial information properly, that is, providing a full and frank account of a company's activities (Thompson and Yeung, 2002). This is due to the fact that corporate transparency is the widespread availability of relevant and reliable information about the periodic performance, financial position, investment opportunities, governance, value and risk of publicly traded firm (Bushman and Smith, 2001).

Furthermore, it has long been recognized that financial statements play an important role in assessing managers' performance by the board of directors, outside investors and external regulators. It is therefore, not unlikely that managers will manipulate financial reports in order to produce a good image of themselves and the firms that they manage through unethical accounting by managing earnings. Earning management is the manipulation of earnings by firms using financial statement elements that are largely at the discretion of the managers to achieve personal or firms goals. These elements are peculiar to industries depending on their nature of operations and external regulatory framework. Researchers such as Klien (2002) have identified that accruals arising from depreciation are used to

manipulate earnings in manufacturing firms. The use of discretion by firm managers to influence reported earnings has long being recognized by accountants and financial economists (Amat, Gothorpe and Perramon 2005, Ahmed 2006). Similarly, torrent of literature exists on the impact of corporate governance on firm performance using one or more of the governance variables of audit committee, board composition, ownership concentration and institutional shareholding (Sanda, Mikailu & Garba 2005: Belkhir 2009). Similarly, several studies conclude that good governance mechanisms can impact on the discretionery behaviour of managers (Warfield, Wild & Wild 1995, Klein 2002, Ahmed 2006 and Shehu, 2011).

Specifically, this study concentrates on Corporate Governance mechanisms of board composition, institutional shareholdings, audit committee and managerial ownership in relation to Earnings Quality. The study is motivated by several factors such as the attributes of the manufacturing sector being a sector that occupies a crucial position of every economy yet little or no attention is given by researchers in ensuring its growth. Even though the banking industry is said to acts as an engine of any economy, and it dominates the Nigerian financial sector (Augusto, 2004), the manufacturing industry also plays a very significant role in providing labor to the grassroots. Added to these is that the issues of CG has long been accepted by most countries including Nigeria to be one of the easiest ways of combating financial irregularities, agency problems, and improving an attractive investment climate. However this is not always the case, and this is what the study intends to find.

1.2 Statement of the problem

Limited access to managerial information causes the providers of finance such as shareholders and debt holders to heavily rely on the financial statement of firms. As financial reporting provides value-relevant information to the external parties of the organization, the heavy reliance placed on accounting numbers create powerful incentives for managers to manipulate earnings to their own advantage (Rahman & Ali, 2006). Hence, it is important for financial accounts to provide the truthfulness and accuracy of financial information to enable the shareholders to make decisions wisely. The lack of accuracy in the financial results will lead to the shareholders and other users making wrong judgments and decisions.

Managers manage earnings to gain investors' confidence by encouraging and convincing stakeholders to invest, however, there are inherent activism that are unethical and fraudulent. The central concern of board composition (which is the extent to which outside directors are represented on the board) with earnings quality is that independent outside directors are expected to protect shareholders specific interest when there is no agency problem. However, this depends on who is on the board, and thus the composition of board members may significantly affect the quality of financial information. It is still not very clear whether the independent directors of Nigerian Manufacturing companies protect the interest of shareholders by preventing earnings management and thus earning quality is increased, does the

independent directors of listed my companies in Nigeria protect the interest of stake holders by increasing earning quality?

While for the institutional Shareholdings it is expected that the more the institutional investors' participate the more the minority shareholder's interest is protected. The significant increase in the institutional investors' shareholdings led to the formation of a large and powerful constituency to play a significant role in corporate governance. The question that still, remains is to what extent does an institutional shareholder checkmate the accounting ethics by managers, thus improving earning quality?

The Audit Committee and Earnings Quality problem may be from the fact that the function of the audit committee is to monitor a firm's financial performance and financial reporting; the audit committee may have a more direct role in improving earnings quality. The presence of well enlightened audit committee may deter unethical intentions by managers thus; it is expected that the quality of earnings will be improved. However, the question that still remains is, to what extent audit committee play a role in improving Earning Quality.

Managerial Owners are expected to reduce accounting ethics in order to protect the shares they own. Many reasons can be adduced for the accounting ethics that may lead to preparation of misleading financial statements. One of such reasons is the demand for high returns by shareholders on their investments. This expectation from investors places management of some companies under undue pressure that they resort to indulging in unethical forms of financial-disclosure and

reporting. Another reason is the quest to maintain a giant corporate status in the eyes of the business community despite some crippling internal problems, odds in the business terrain or sporadic changes in competitiveness. Also, the craze to satisfy the interest of company's insiders by manipulating the financials, understating or reclassifying expenses is another reason. These of course set the stage for the failure of the company with time. The consequences of these unethical accounting practices include, but not limited to a wide gap between reality and the reported position of the company such that any person placing reliance on such reports for decision making will be misled, erosion of investor's confidence in corporate entities, attrition of revenue to the government via evasion or avoidance of taxes, reduction in the inflow of foreign direct and portfolio investment. And the question still remains, as to what extent does the managerial owners protect the interest of shareholders and improve the quality of earnings?

The Corporate Governance Culture in Nigeria failed to be Responsible to the Stakeholders, Accountable to the Shareholders and has no deep-rooted mechanism to maintain a balance among the major players (board of directors, shareholders, and management) in corporate governance which have resulted in poor financial reporting quality (Shehu, 2011). The challenges and failure of corporate governance in Nigeria stems from the culture of corruption and lack of institutional capacity to implement the codes of conduct governing corporate governance. Company executives enjoy an atmosphere of lack of checks and balances in the system to engage in gross misconducts since investors are not

included in the governing structure. How strictly the listed manufacturing firms comply with the provisions of corporate governance code?

Studies such as (Mark 1996, Bello 2002, Klien 2002, Adams and Mehran 2003, Schipper and Vincent 2003, Park and Shinn 2004, Borgia 2005, Sanda et al 2005, Fodio 2006, Rahman and Ali 2006, Ahmad 2006, Devi and Hashim 2010), concentrated on either the banking sector or some sectors of manufacturing companies. In addition, most of the studies used Ordinary Least Square (OLS) without considering the robustness of the techniques, while this study conducted a robustness test to ensure the validity of the statistical inference derivable from the results. However, this study is said to fill the obvious methodological gap discovered by the previous studies specifically the robustness tool of analysis.

The study therefore examines the influence of Corporate Governance mechanisms on the quality of financial reports of quoted manufacturing firms in Nigeria.

1.3 Objectives of the study

The main objective of the study is to examine the effect of Corporate Governance on Earnings Quality of listed Manufacturing companies in Nigeria. The specific objectives include:

i. To determine the effect of Board Composition on the Earnings Quality of listed manufacturing Companies in Nigeria.

ii. To determines the effect of Institutional Ownership on the Earnings Quality of listed manufacturing Companies in Nigeria.

iii. To determine the effect of Audit Committee on the Earnings Quality of listed manufacturing Companies in Nigeria.

iv. To determine the effect of Managerial Ownership on the Earnings quality of listed manufacturing Companies in Nigeria.

1.4 Hypotheses of the study

In line with the studies objectives, the following hypotheses were formulated in a null form.

Ho1: Board Composition has no significant effect on Earnings Quality of listed manufacturing firms in Nigeria.

Ho2: Institutional Shareholdings has no significant effect on Earnings Quality of listed manufacturing firms in Nigeria.

Ho3: Audit Committee has no significant effect on Earnings Quality of listed manufacturing firms in Nigeria.

Ho4: Managerial Ownership has no significant effect on Earnings Quality of listed manufacturing firms in Nigeria.

1.5 Scope of the study

The scope of the study is limited to the listed Manufacturing companies in Nigeria. There are 59 Manufacturing Industries in Nigeria which are divided into four strata, that is, Food and Beverages, Building Materials, Chemicals & Paints and Conglomerates. It covers period of 6 years (2006 – 2011). And the selection of the period is informed by the commencement of compliance investigation by SEC on the code of CG. The study focuses on only four of the CG mechanisms; that is Board Composition (BC), Institutional Ownership (IO), Audit Committee (AC) and Managerial ownership (MO) which stands for the independent variable and the accounting ethics which is measured as Earnings Quality (EQ) as the dependent variable.

1.6 Significance of the study

The findings of this study can have implications for users of financial statements such as shareholders, potential investors, policy makers, the regulatory bodies and also students. The study is expected to practically contribute in strengthening the areas of concern by practitioners such as external auditors and financial consultants in manning the financial records of Nigerian Listed Manufacturing Companies (NLMC) relating to the role of CG practice. Again, the Board of directors and regulatory agencies of NLMC in discharging their duties of policy making and regulating respectively. And also to consider the prominent roles or activities that CG mechanisms play in

checkmating and preventing as well as minimizing the possible opportunistic accounting by managers in preparing the financial statement of the firms.

Theoretically, the findings of this study is expected to provide additional literature in the areas of CG and quality of accounting numbers. This will go a long way in validating theories, such as agency that anchored CG mechanism and EQ in NLMC.

In particular, financial statement users should be aware of income the users should be aware of income smoothing and the factors affecting such behavior when they rely on financial statements to help them make decisions. Specifically, users are expected to know the influence of the independent or non-executive directors, institutional shareholdings and the audit committee on such behavior.

Further, since extensive accounting ethics may lead to inadequate or misleading income disclosure, thus regulators should concentrate their efforts where such practices are likely and most extensively to happen.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter review relevant literature related to Corporate Governance (CG) and Earnings Quality (EQ). The review focuses on conceptual and empirical literature related to CG and EQ. The chapter also presents review of relevant CG models and methods of measuring EQ.

2.2 Historic back ground of Corporate Governance

Corporate governance (CG) has a very long history, according to Berle and Means (1932) CG issues have been around since the eighteenth century as the precedence for modern corporate governance. Francis, (1997) in McCabe (2002) suggested that the corporate form of business enterprise, with multiple owners of structured entity can trace its origin from the Romans times at least. Hence, the problem of CG is expected to have long been addressed.

However, earlier in the sixteenth century, the British East India Company received its charter from the queen Elizabeth 1, (Monks and Minor 2008). Then two years later the Dutch East India Company received their royal charter with permanent capital and shares of unlimited duration. And in the seventh century the first joint stock company was said to emerge from Britain and Holland.

Gradually the need to enhance the efficiency of CG became paramount, as in the 19th century, the state corporation laws enhanced the rights of corporate boards to govern without the concept of shareholders in exchange for statutory benefits like appraisal right. And as a result of shareholders complain over administrative pay back and stock losses, the need for CG reform became necessary, at this period, the term CG became an established field of literature (McCabe 2002).

Suddenly, the rights of owners and shareholders became increasingly dissipated as a result of the administrative friendly Delaware law, and then most publicly traded companies in the United States wealth have been increasingly scrutinized. And in the twentieth century the need to change the role of Modern Corporation in the society became pounding following the aftermath of Wall Street of 1929, (Barle and Means 1932). Monks and Minor (2008) asserted that the term CG was not in literature until 1985. While Zingales (1997), believed that the term CG came into existence twenty years ago, and Beasley 1996 asserted that CG seem to have been used first by Richard Ell 1960 to denote the structure and function of the corporate polity.

Consequently, in the early 90's the issues of CG received considerable press attention in the united states as a result of the wave of CEO dismissal while in 1997, the Asian financial crises saw the down fall of various Asian countries as a result of exit of foreign capital after property assets collapsed.

Later, in the 2000's the massive bankruptcies and criminal malfeasance of Enron and WorldCom as well as the lesser corporate debacles, led to increased shareholder and government interest in CG. However, many moves were made to address the issues of CG, like the establishment of the Cadbury committee in the early 90's and later the passage of Sarbanes-Oxley Act of 2002. From then many countries begin to develop their codes of best practice.

In Nigeria the codes of CG was issued by SEC and CBN in 2003, and has address the issue of BOD, shareholder and the audit committee. For the BOD the code recommends a board size of not more than 15 and not less than 5 including executive and non-executive directors. The minority shareholders are also fully represented by at least one director on the board. The code was explicit in prescribing the power of separation between the chairperson and the chief executive.

To ensure capability and independence the attendance at meetings must be captured, hence the code requires that the notice of meetings must reach shareholders in nothing less than 21 working days to the date of the meeting and also the meeting must hold at easily accessible and affordable distance.

In the case of the auditors the code emphasizes that the number of executive directors (EDs) on the audit committee must be limited to one with other members as nonexecutive directors (NEDs) and a strong NED to serve as the chairman, so also the tenor of the members of the committee will be fixed and there will be option for election. There should also be at least three meetings in a year. The code

further requires them to meet at least once in a year with the external auditors in the absence of the executive board members. The code suggest a term of reference for members in line with section 356 (6) (a) - (e) of CAMA (1990).

2.3 The Concept of Corporate Governance

The concept of CG is very wide considering the way and manner it has penetrated the minds of numerous researchers. Thus, the concept has various definitions from the accounting, economic, political and legal points of view. Despite these, CG can be broadly divided into at least two; the narrow and the broad view. The narrow view which is referred to as Anglo- Saxon is concerned with the structures within which corporate enterprise receive its basic orientation and direction (Rwegasira, 2000). The proponents of the narrow view considers the interest of the shareholders, issues relating to shareholders protection, management control and the popular principal-agency problem of economic theory are given prominent attention. They affirmed that CG deals with the relationship between corporate managers and shareholders. They also posited that providers of finance have a unique relationship to the firm as they allow their investment to be placed at risk, (Alchain and Demsetz 1972, Jensen and Mackling, 1976 and Hart and More, 1990) while the productive asset they finance remains the property of the corporation (Shliefer and Vishny 1997).

The second category consists of the proponents of the broader view referred to as Franco-German which is also said to be the heart of both market economy and a democratic society (Sullivan, 2000). The Franco-German considers the interest of

the stake holders, that is, the shareholders, managers, directors, creditors, customers, society, government and legal authorities/agents. In addition to this, Sullivan (2000) concluded that the resultant problems of the privatization crusade, transition economy, issues of institutional, legal and capacity building as well as the rule of law are at the very heart of CG.

From the stakeholders perspective, Aguilera (2005) took a broad view to define CG as the study of the distribution of rights and responsibilities among different participants in the corporation such as managers, shareholders, the board of directors and other stakeholders e.g employees, suppliers, and customers. He however ignored crucial issues such as management and social responsibility. CG can also be as the act of at safeguarding the interest of stakeholders as they ensure that all parties interested in the wellbeing of the firm attempts to ensure that managers adopt mechanism that safeguards the interest of stakeholders (Sanda et al, 2005).

According to Borgia (2005), a shared definition of CG, which is both valuable and consistent, is not easy to find and CG definitions are often unclear, inconsistent, or partial and subjective. He thus went further to define CG as the set of criteria and tools necessary to assure steady value creation in continuity and guarantee strategic effectiveness and operational efficiency to an organization, in compliance with the rules, and in his paper, he gave the first step the Organization for Economic Cooperation and Development (OECD 2005:8) took to defines CG as;

> Corporate Governance is affected by the relationships among participants in the governance system. Controlling shareholders, which may be individuals, family holdings, bloc alliances, or other corporations, acting through a holding corporation or cross shareholdings, can significantly influence corporate behavior. Corporate Gover nance is only part of the larger economic context in which firms operate, which includes, for examples, macroe conomic policies and the degree of competition in product and factor markets. The Corporate Governance framework also depends on the legal, regulatory, and institutional environment. In addition, factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which it operates can also have an impact on the reputation and long-term success of a corporation.

Earlier in 2003, in trying to tackle the qualitative and quantitative issues of efficiency in complex decision process, Adams and Mehran (2003) asserted that CG has a major direct effect on the socioeconomic growth and development of a country as finance and investment decision have a strong impact on development process.

According to Shleifer and Vishny (1997), CG is the system by which companies are directed and managed. It influences how the objectives of the companies are set and achieved, how risk is monitored and assessed, and how performance is optimized. A good Corporate Governance structure encourages companies to create value through entrepreneurism, innovation, development and exploration and provide accountability and control systems commensurate with the risk involved.

The Commonwealth Business Forum representing the private and state-owned corporate sector emphasized the significance of CG in 1997. A resolution was passed by the forum to the effect that capacity should be established in every Commonwealth country to create or reinforce institutions to promote best practice in corporate governance; in particular, codes of good practice establishing standards of behavior in the public and private sector should be agreed to secure greater transparency and to reduce corruption (Anyaoku, 2000). However, in spite of these emphases, the CG codes of best practice that were laid down but not strictly adhered to, led to a series of systemic collapse and financial crises around the world. During this period companies and banks in Nigeria record earnings, apparently, many also reported earnings that existed only briefly on their accountants ledgers (Beasley, 1996).

According to Monks and Minor (2008), seven of the twelve largest bankruptcies in American history were filed in 2002 alone. This is as a result of series of financial scandals, corporate meltdowns, frauds and other financial debacles. This catastrophe led to loss of jobs, criminal investigation, and destruction of a lot of billions of dollars among others, which necessitated a series of investigations by countries and regulatory authorities in order to address corporate issues. The investigation pin points the mystery about the disaster, and it was later found that CG requires a complex system of check and balance. Monks and Minor (2008) also added that it requires a whole village to make it work. Thus just having elaborate CG codes and highly qualified board does not prevent the collapse of firm as in the case of Enron.

For a business to effectively and efficiently progress good CG principles need to be inculcated into the way and manner the activities of the enterprise are carried out. To achieve this, the organization must play a very significant role in encouraging the managers to exercise their rights by effectively communicating transparent, understandable and accessible information to the shareholders. Unfortunately, this is hardly the case as managers tend to abuse the latitude of choice by hiding under the cover of creative accounting to manipulate figures through window dressing or smoothening income, which is called earnings management- the practice of using accounting tricks to mask a firm's true operating performance (Warrick, 1999). The quality of earnings is usually assessed from the financial reports while publicly reported accounting information can be used as important input information in various corporate governance mechanisms (Bushman and Smith, 2001).

The codes of CG came up to solve the problems as it has address issues of BOD, shareholders, audit committee Board Size (BS), Board Composition (BC), Power Separation (PS), Audit Committee (AC), Institutional Ownership (IO), Managerial Ownership (MO), Institutional Shareholdings (IS).

2.4 Concept of Earnings Quality

Earnings quality is an important aspect of evaluating the entities of financial health; yet, investors, creditors, financial suppliers, and other users often overlook it (Amat et al, 2005). Even though there has not been any accepted definition and

approach to measuring the quality of earnings (Abdelghany, 2005), the need to understand it cannot be over emphasized. The Generally Accepted Accounting Practice (GAAP) offer some flexibility in preparing financial statements and gives financial managers some freedom to select among accounting policies and alternatives (Abdelghany, 2005). Therefore, depending on the methods selected and estimates that must be made, a firm's reported earnings can vary considerably and yet be in compliance with GAAP.

Theoretically, Investors prefer a smooth and stable income streams Modigliana and Miller (1958), as they are only after a positive return, thus investors will prefer to invest in such companies Bello, (2006). Investors however forget that it is not how much money a company is making but how it makes the money that matters and ignoring the fact that managers can manipulate result and still go scot free. The latitude in choice given by GAAP is commonly referred to as income smoothening (Bello, 2003). While in Accounting Literature another expression for income smoothing is earnings management (Belsk; and Brozorsky 2002). However according to Bello, 2002 the two can be interchangeably.

Abdelghany (2005) reported that Earnings Management behavior may affect the quality of accounting earnings which is defined by Schipper and Vishny (2003) as the extent to which the reported earnings faithfully represent Hichsian economic income; that is, the amount that can be consumed (i.e paid out as dividends) during the period, while leaving the firm equally well off at the beginning and the end of the period. Lo (2007) asserted that earnings management has a lot in common with

earnings quality, that highly managed earnings have low quality, however, the lack of earnings management is not sufficient to guarantee high quality earnings or high quality accounting numbers, because more generally, other factors contribute to the quality of earnings.

Amat et al, (2005) drew the definition of earnings management from Pratts and Penman (2000) as the ability of reported earnings to reflect the company's true earnings and to help predict future earning as they consider earnings stability persistence and lack of variability to be key. In another view, Magrath and Weld (2002) indicate that abusive earnings management and fraudulent practices begins by engaging management scheme designed primarily to "smooth" earnings to meet internally or externally imposed earnings forecasts and analysts' expectations.

Ostensibly, managed earnings do not give a transparent position of the financial status of companies; it rather gives a picture of poor adherence to CG mechanism. Even though sometimes earnings are managed to increase the quality of the earnings itself, most a times the managers manage earnings to their advantage alone which more often is detrimental to the business as a whole. As a result of these and more a lot of codes of best practice have become very popular. In Nigeria, the CBN codes and the SEC codes are operational. While the blue ribbon committee which was sponsored by New York stock Exchange (NYSE) and the National Association of Security Dealers (NASD).

The latitude in choice given by Generally Accepted Accounting Practice (GAAP) is commonly referred to as income smoothing, (Bello, 2002). While in

accounting literature, another expression for income smoothing is earnings management (Belski and Brozovsky, 2002). However, some authors (eg Dye 1988 and Trueman and Titman 1988) were able to differentiate between the two; earning management occurs when managers reports a number different from actual earnings to shareholders without facing intertemporal restriction on the discretionary amount that they report, while on the other hand income smoothing requires the reported earnings figure to add up to the actual earnings figure over a period of time. However, according to Bello (2002), the two can be used interchangeably.

Levit (1998) defined earning management as a grey area where accounting is being perverted; where managers are cutting corners; and where earnings reported reflect the desires of managers rather than the underlying financial performance of the company. From these definitions, it can be said that both income smoothening and earnings management can be regarded as unethical accounting, (Shehu, 2011).

There are various definitions of income smoothing and according to Dictionary of Business (1996) Income Smoothing involves "Manipulation by companies of certain items in their financial statements so that they eliminate large movements in profit and are able to report a smooth trend over a number of years" ostensibly because of the belief that investors have greater confidence in companies that are reporting a steady increase in profits year by year. Income smoothing has also been described by Watts and Zimmerman (1990) as the exercise of discretion

over accounting numbers by managers with or without restrictions such discretion can be either opportunistic or firm value maximizing.

Furthermore, managers know different hooks and croons of managing earnings, and in some cases they over state profits available for dividend by omitting liabilities, crediting a range of capital receipt to revenue and debiting revenue expenses to capital (Polins, 1956), and at the end, investors woke from a dream of boundless wealth to a reality of general ruin (Adams, 1886). Investors should not be after how much money the business is making but how it makes the money, because companies in the winners table generate a lot of sustainable cash from their operations and as such have the best EQ, while companies in the losers table keep reporting with tricks as unexpected stock options, low tax rates, assets sales, off balance sheet financing, differed maintenance of pension funds.

2.4.1 Earnings Management incentives

There are many reasons why managers manage earnings. Abdelgeny (2005) stated that at the period of management change either as a result of termination of appointment or end of tenure many irregularities are done. Consequently, the new CEO may shift part of the income to the time he will be evaluated and appraised. The blame of his low earnings at the beginning of his contract will be pointed to the act of previous CEO. Ortega and Grant (2003) asserted that Firms have incentives to manage earnings to help achieve a smooth and growing earnings stream. This is as a result of the investors' dear need for a more stable earnings; and pattern thus, managers tend to smooth earnings towards a long term sustainable trend.

In trying to meet the bonus plan requirements, earnings are managed in the direction that is consistent with maximizing executives' earnings-based bonus, (Healy 1985). Earnings are either managed upwards or downwards to earn a minimum or maximum bonus. Thus, if earnings are below the minimum level required for bonus to be earned, managers employ earnings management techniques to bring earnings up, if earning are above the maximum level at which no additional bonus is paid, then earnings will be managed.

Magrath and Weld (2002) indicated that improper revenue recognition is the cause of one-third of all voluntary or forced restatement of income filed with the SEC from 1977 to 2000. However, management usually commit itself to analysts and investors by providing estimates which at the end leaves the management with the problem of ensuring that these estimates are met at all cost. In order to avoid this, some companies try to shift their focus from meeting short-term earnings estimates to achieving their long-term strategies. Thus, companies like Coco-Cola Co., Intel Corp., and Gillette Co., have taken a contrary stance and no longer provide quarterly and annual earnings estimates to analysts and investors (Abdelghany, 2005).

Earning management can also occur when some firms have the incentive to lower earnings in order to minimize political cost associated. Consequently, some firms in order to avoid debt covenant violation may use earnings-management techniques to increase earnings. Abdelghany (2005) related that some firms have

the incentives to avoid violating earnings-based debt covenants which if violated, the lender may be able to raise interest rate on debt or demand immediate payment.

Healy and Whalen (1999) identified examples of these commercial pressures to include: failure to meet market expectations or target, performance tied compensation to directors and managerial including stock options.

2.4.2 Earning Management Techniques

Schilit, (2002) identified the following seven techniques used by managers to manage earnings.

i. Recording of revenue too soon or of questionable equality (e.g recording sales while future services remain to be provided).

ii. Recording bogus revenue (e.g recording of sales that lacks economic substances).

iii. Boosting income with one-time Gain (e.g. boosting incomes by selling undervalued assets).

iv. Shifting current expenses to a later date or earlier period (e.g Amortizing costs too slowly or failing to write- off impaired assets.

v. Failing to record or improperly reducing liability (e.g recording revenue when cash is received even though future obligations remain, releasing questionable reserves into income.

vi. Shifting current revenue to a later period – e.g creating reserves and releasing them into income at a later period.

vii. Shifting future experience to a current period by improperly writing -off costs from an acquisition.

2.5 Corporate Governance and Earnings Quality

A torrent of literature acknowledge the importance of corporate governance mechanisms to improve financial reporting quality and earlier researches have demonstrated that good governance help in reducing the risk of financial reporting problems (Ahmed, 2006 and Hashim and Devi, 2008). Hermanson (2003), added that 'Good governance goes in-hand with reduced risk of financial reporting problems and other bad accounting outcomes'. Researchers have found evidence on the association between poor governance and poor quality of financial reporting including earnings manipulation, financial restatements and frauds (Beasley, 1996; Dechow, Sloan and Sweeney, 1996 and Hashim 2003).

The findings of other researches prove that managed earnings exhibit different predictive ability of future cash flow depending on the apparent motivation behind earnings management. They concluded that managed earnings classified for

opportunistic reasons are less predictive of future cash flow relative to earnings restated (managed) numbers. While managed earnings for informative reasons exhibit greater predictive ability with respect to future cash flows relative to restated (unmanaged) numbers. Hence, both cash from operations and changes in working capital accounts (accruals) are used to manage earnings (Magrath and Weld, 2002).

Many researches have also been carried on the relationship between corporate governance and accounting discretion (AD). For example, Mohan et al. (2002), in his findings concluded that there is no relationship between accounting discretion (AD) and either managerial compensation or government structures, but they pointed out that an association between weak government structures and accounting discretion parse need not apply managerial opportunism. In addition, they allowed for possibility that an average accounting discretion can even benefit shareholders by say allowing managers to signal wide information about future performance.

In an earlier study, Watts and Zimmerman (1990) stated that "one function of financial report is to constrain managers to act in the shareholder's interest". Given the increasing complexity of business today, there is need for financial reports to include more comprehensive information as investors rely on information they receive from companies in making their investment decision. In the same line, the global institutional opinion, survey of McKinsey and Company in 2002 on CG issues, found that the majority of the investors agree that Corporate Governance

remains of their great concern with strengthening the quality of AD as the top priorities as majority of investors are willing to pay a higher premium to companies with good CG. Hence, larger firms face more political cost and thus have incentives to exercise accounting discretion to reduce unwanted political visibility (Watts and Zimmerman, 1990).

Hashim (2003) and Hermanson (2003) stated that good CG goes hand-in–hand with reduced risk of financial reporting problems and other bad accounting outcomes. Other studies such as Baurer, Gilster and Otten (2004) found that a negative relationship exists between governance standards and earnings base performance ratio (net profit margin and return on equity), contrary to Gomper, Joy and Andrew (2003).

2.5.1 Board Composition and Earnings Quality

According to Hannifa and Cooke (2002) board composition is the proportion of outside directors to the total number of directors. Thus, who the board should comprise of is another very important tool for efficient governance, and the board comprising majority of outside directors have the tendency of reducing agency conflict as they provide effective monitoring tool to the board, (Fama and Jensen, 1983).

There are two views on this issue of board composition – those who argue for more non-executive directors on boards and those who favour more executive directors on boards. For those who support more non-executive directors on the board based their arguments on two theories; agency and resource dependency. An

important question of board composition concerns the ideal combination of outside and inside members. Outsiders are more independent of a firm's CEO, but are potentially less informed regarding firm projects than insiders. Insiders are better informed regarding firm projects, but have potentially distorted incentives deriving from their lack of independence from the firm's CEO (Hannifa and Cooke, 2002).

The premise of agency theory is that boards are needed to monitor and control the actions of directors due to their opportunistic behavior (Berle and Means, 1932, Jensen and Meckling, 1976). Fama and Jensen (1983) argued that the inclusion of outside directors increases the board's ability to be more efficient in monitoring the top management and to ensure there is no involment of top managers to expropriate stakeholders wealth as the incentive to develop their reputation as experts in decision control. The Malaysian code of CG related that good CG rests firmly with BOD and the code requires one third of the board to comprise independent non-executive directors in order to bring an independent judgment on the decision process (Hashim and Devi, 2010).

The outside independent directors are expert managers from other larger organizations and with expertise and independence, objectivity and legal power (Hashim and Devi, 2003). The outside directors become potentially powerful governance mechanism to mitigate agency costs and protect shareholder's wealth (John and Senbet; 1998). It is however a general belief that board of directors are more independent as the proportion of outside directors increases (Millstein and Mac Avoy, 1998, and Rosennstein and Wyatt, 1990) in (John and Senbet; 1998).

However, the research earlier conducted by Smith (1976) indicates that by way of delimitation the incident of smoothing behaviors is more evident in manager-firm than in owner-firm, ostensibly for concerns for job security.

In Nigeria, Fodio (2006), investigated whether the three Corporate governance variables – board composition, board size and power separation between board chairperson and chief executive officer have significant impact on bank performance and sales growth and value, found out that there is no significant impact on sales growth, but the Corporate Governance Variable have significant impact on ROE and Tobin's Q .

Hashim and Devi (2003) examined the relationship between internal monitoring mechanisms namely the role of board independence and the ownership structure (managerial ownership, family ownership and institutional ownership) and the financial reported earnings quality. Using data from 280 non-financial companies listed on Bursa Malaysia's Main Board for the year 2004, this study fails to find any significant evidence on the relationship between the traditional functions of board of directors (i.e. proportion of independent non-executive directors) and earnings quality measured by accrual quality model. However, this study finds positive significant associations between proportion of family members and earnings quality which suggest that concentrated shareholdings in family ownership have incentives to reduce agency costs through a better alignment of shareholder and managerial interests.. The study used performance variables as control variables without transformation which could give a different result if use as continues variable in the model.

Kamaruzaman, Mazlifa, and Maisarah (2009) provided evidence for the transparency level on income statements with regards of firms' characteristics of 150 main and second boards companies listed on the Bursa Malaysia. The characteristics were grouped into three groups of variables: structural (firm size, leverage and number of shareholder), market related (listing type and industry type) and performance (profit margin, return on equity and liquidity). The study was started with the development of a Transparency Index based on the percentage of the details of expenses disclosed in annual reports (notes to the accounts) over the total expenses of the company. The findings suggested that this index on the average for the companies in the sample is about 64% with three companies scoring transparency index of 100%. Both univariate and multivariate statistical analysis were performed on the data. The stepwise regression method indicated that only one variable was significant at 5% which was the Number of Shareholders (LnNOSH). The other factors were not significant. A major difficulty in determining the total expenses are cost of ambiguous nature of certain expense item disclosure. For example, depreciation expense is not clearly identified as to whether it is in the cost of goods sold, selling and administration expenses and many others. In addition, the cost of sales may also lead to bias for non-manufacturing and trading companies, that is the service industries. Therefore, the item cost of sales or cost of goods sold is excluded from the total expenses. Hence, this is the major limitation of the income statements transparency index constructed and used in this study.

Adelopo (2010) examined voluntary disclosure practices among listed companies in Nigeria. Results from Univariate and Multivariate analyses of 52

listed companies, representing 41% of the population studied, suggest an average voluntary disclosure of 44% based on modified Meek et al (1995) disclosure index comprising 24 disclosure items. The study found significant positive relationship between voluntary disclosure and firm size, measured as the natural logarithm of total asset. Significant positive relationship was also found between market based definition of firm performance and voluntary disclosure. Percentage of block share ownership and percentage of managerial share ownership were found to be negatively related to firm disclosures.

Adebimpe and Peace, (2011) examined the association between corporate governance, company attributes and voluntary disclosures among Nigerian listed companies. In order to examine this association, two disclosure indexes were built using a sample of 50 listed companies in Nigeria. The first index contains twenty items which are mandatory according to a number of selected IFRSs but which are voluntary in Nigeria for the year 2008.The second index contains sixty voluntary accounting and non-accounting items. The study uses univariate, multivariate and cross-section models to explore the relationship between each disclosure index and corporate attributes. The corporate attributes are the independent variables comprising corporate governance and company characteristics. The results of the regression analysis reveal that only board size has a significant positive relationship with the extent of voluntary disclosures on the sample companies. The Board composition is statistically positive and insignificant impact on disclosures. The effect of Board ownership is positive for IFRS disclosures but negative and

insignificant for Non-IFRS disclosures while sector is negative for both disclosures but has a significant effect on Non-IFRS disclosures. The limitations encountered in this study include the insufficient weighting of scores for disclosure criteria in the sense that companies were awarded 1 for disclosure of an item and 0 for non-disclosure without considering the depth of the disclosure of such item in the annual report. Also, the inability to access annual reports covering longer periods rather than just a year inhibits the generalization of the findings to an extent.

Park and Shin (2004) however, did not find empirical support on the association between earnings management and board independence for their Canadian sample where the corporate governance is highly concentrated and a large block holder controls the public traded firms in Canada. Additionally, study by Abdullah and Mohammed (2004) and Abdulrahman and Ali (2006) did not also find any significant evidence between independence of boards and earnings management in the Malaysian firms. This may be as a result of non – inclusion of financial firms in their sample. Furthermore, study by Jaggi *et al.* (2007) provided evidence of insignificant relationship between proportions of non-executive directors and accrual quality in high family-ownership samples of Hong Kong listed firms which suggest that the monitoring effectiveness of independent directors is reduced in family controlled firms. The result may be different if the study includes other firms not only family controlled firms because the independent directors are selected base on merit rather than family consideration.

Dechow, Sloan and Sweeney (1996) analysed 436 firms for the period of 11 years with a final sample after eliminations of 92 firms. Each firm is matched in the year prior to manipulation to a control firm and with similar asset values. The authors provided some evidence that accruals appear to be high at the time of manipulation. However, various corporate governance factors appear to be correlated with manipulation. For example, they find that manipulating firms have a higher number of insiders on the board. This implies that with higher number of outside directors a firm will be expected to experience minimum earnings manipulations.

2.5.2 Institutional Shareholdings and Earnings Quality

The institutional shareholdings refer to the shares held within the firms. It is argued that shares held by directors increase their level of commitments in creating long term value because they stand to enjoy when the business prosper. According to Hashim and Devi (2003), institutional investors' participation has emerged as important force in corporate monitoring to serve as mechanisms to protect minority shareholder's interest. Considering the influence of shareholder activism in governance reforms, it is important to obtain insight into governance practices (Daily et al., 2003). Claessen and Fan (2002) added that to mitigate the problems associated with conflict between controlling owners and minority shareholders in Asian firms, the involvement of institutional investor's equity participation may improve CG.

Koh and Hsu (2003) in their study of associations between institutional ownership of Australian non-financial listed companies and earnings quality, found a negative relationship between concentration of institutional ownership of shares and income increasing accruals that potentially affect the quality of reported earnings. By maintaining their shareholding, institutional investors are able to affect the quality of information being reported to the public in the long-run. Related to this information-performance perspective, is the ability to ensure market participants are continuously informed of the company's actions.

Abdurrahman and Mohammed (2006) examined the relationship between institutional shareholdings and accounting earnings quality (measured by earnings response coefficient) and find evidence that the presence of institutional investors lead to lower earnings quality as predicted in their hypothesis. He argues that Malaysian institutional investors prefer short-term investment rather than long-term achievement that make their decision to dispose their substantial shareholdings inevitably depress the market share price dramatically that support 'myopic investor' hypothesis. However, institutional investors use corporate governance practice as a measuring tool for their investment decisions which suggest that firms with better corporate governance practices attract higher institutional ownership from institutional investors.

The significant increase in the institutional investors' shareholdings especially in firms has led to the formation of a large and powerful constituency to play a significant role in corporate governance (Claessen and Fan, 2002). Mitra and Cready (2005) provided evidence that active monitoring from the institutional

investors also help to prevent managerial opportunistic reporting behaviour and improve the quality of governance in the financial reporting process. They found that institutional shareholders intervene and mitigate the self-serving behaviour of corporate managers in financial reporting based on a sample of 136 firms that belong to the S&P 500 group and 237 that belong to non- S&P 500 category for eight years period (1991-1998). Another claim is that institutional investors should also play an important role in ensuring good governance of their investment-companies. This argument relies on the fact that such institutions through concentrated ownership of shares, together with the financial strength and expertise of the institution are able to effectively overcome the problem of diffused shareholding. The Cadbury Report (1992: 10) specifically stated that "given the weight of [institutional investors'] votes, the way in which [the institutions] use their power to influence the standards of corporate governance is of fundamental importance".

Chung *et al.* (2005) found evidence that institutional shareholders moderate the discretionary accrual and surplus free cash flow relationship when the surplus free cash flow is high. The presence of institutional investors with substantial shareholdings restrain managers from engaging in income increasing discretionary accruals when firms have high free cash flow, however, when there is no free cash flow agency problems, the institutional investors do not effectively constrain the management's use of income increasing discretionary accrual.

2.5.3 Audit Committee and Earnings Quality

As a result of the conflict of interest between the managers and the shareholders, there is the need for auditors to intervene so as to assure the shareholders that the accounting books show a true and fair view and are in agreement with the accounting policies. Even though the boards of directors are responsible for oversight of the financial accounting process, this task is often delegated to a subcommittee of the full board, the audit committee. Beasley (1996) indicates that audit committee plays an important role because it is concerned with establishing and monitoring the accounting processes to provide relevant and credible information to the firm's stakeholders. Thus, many bodies have stipulated roles of the auditors in ensuring this is achieved.

It is generally believed that members who are independent from management are better monitors. Previous studies have provide plenty of evidence that an independent audit committee is better at monitoring financial reporting and auditing process of the firm (Abbott and Parker (2002) (Carcello and Neal (1997)) Moreover, some studies have examined the negative link between the independence of audit committee and earnings management using sample of United States (Wu and Hsu 2007); Klein (2002); Felo et al (2003).

Abdullah and Hussin (2009), defined the term independence in the Malaysian context as refers to two crucial aspects, independence from management and independence from significant shareholders. The Revised Malaysian Code on Corporate Governance 2007 reinforces the desirability of audit committee independence by excluding executive directors from membership. Meanwhile, the

SOX requires firms to have audit committees comprised solely of independent director who is not an affiliate of the firm and not accepting any compensation from the firm other than director's. the study find that an audit committee member who is appointed by the incumbent CEO may face obstacles in becoming an effective monitor, and audit committee independent lack of seniority on the board may adversely affect his/her ability to scrutinize top management and raise concerns over questionable accounting practices.

Wu and Hsu (2007), examined the relationship between board structure, audit committee structure and the incidences of corporate failure in U. K and the study find that independent outside directors on the audit committee could not effectively contributes to decrease the likelihood of corporate failure. They also found that failed firms are more likely to employ key directors (CEO, Chairman and Finance director) on the audit committee.

Researchers generally classify outside directors into one of the two categories: "independent directors" and "grey directors". Grey directors include former officers or employees of the company or a related entity, relatives of management and professional advisors to the company Carcello and Neal (2000), while independent directors have no affiliation with the firm other than being on the board. Previous studies have shown that the personal or economic affiliation that grey directors have with the corporate management may impair their independence. For example, Carcello and Neal (2000) found that the percentage of inside and grey directors has a negative relationship with the probability that the auditor will issue a going-concern report when the firm is experiencing financial distress. Therefore the

presence of those grey members on audit committee may impair the monitoring effectiveness of audit committee. Aware of this problem, BRC (1999) recommends that audit committee should be comprised only of independent directors.

The Cadbury report does not require a totally independent audit committee, but just suggests that the membership of audit committee should be confined to non-executive directors and majority of outside directors serving on the committee should be independent. Another important variable which could affect the effectiveness of audit committee is the member competence. Independent directors may have intentions to curb accrual –based or real earnings management behaviors for shareholders, but they may not be able to do so without certain level of financial knowledge. BRC 1999 recommends that each member of audit committee should become financially literate and at least one should have accounting or related financial management expertise. The positive effect of audit committee members who have financial expertise is supported by a number of empirical studies. Abbot and Parker (2002), suggested that the premise underlying the expertise recommendation is that committee member must have the ability to carry –out their functions effectively. They must possess financial acumen and knowledge of the business environment to be able to read and understand financial statements.

Blue Ribbon Committee of U.S A (1999), defined financial expert as 'past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which resulted in the individuals sophistication, including being or having being a CEO or other senior officer with financial oversight responsibility in a particular organization.

Abbot, Parker and Peters (2002) found the incidence of independent directors with accounting or finance background on audit committee is negatively related to the probability of earnings restatement

Cadbury report 1992 does not mention the importance of the member's financial expertise, but the Audit Committees Combined Code Guidance 2003 recommends that "at least one member of the audit committee should have significant, recent and relevant financial experience, for example as an auditor or a finance director of a listed company. It is highly desirable for this member to have a professional qualification from one of the professional accountancy bodies". This change reveals that the qualification of audit committee members has been realized as an important issue for the corporate governance of Nigerian firms (Dabor and Adeyemi 2009).

According to US experience, member expertise can increase financial reporting and auditing quality, decrease the probability of accounting manipulation, so it is probable that the financial expertise of audit committee members can increase their ability to detect and constrain real earnings management.

The size of the audit committee is another important determinant of audit competence. Companies and allied matters act 90 law of federation of Nigeria provided that in compliance with corporate governance standards, the audit committee shall consists entirely of three directors and three shareholders

Felo et al. (2003), documented a positive Relationship between financial reporting quality and audit committee size in a univariate analysis. This could arise if a larger committee size increases the resources available to the audit committee

and improves the quality of its oversight. The Blue Ribbon Committee Report also suggested that given the complex and important nature of the audit committee's responsibilities, '…the committee merits significant director resources, both in terms of the number of directors dedicated to the committee and the time each director devotes to committee matters.' Given that audit committees are not so large that co-ordination and other problems are likely to arise, we expect a positive relationship between change in audit committee size and change in financial reporting quality.

The audit committee also play an effective role in ensuring competence. Klein (2002), studied audit and board characteristics in relation to earnings management, that as the number of board meetings increases, the operation performance of the firms will be improved, this suggest that the frequency of meeting is an important dimension of an effective board. A board that meets more often should be able to devote more time to issues such as earnings management, than board that seldom meet may not focus on these issues and may only rubber – stamp management plans. A common proxy for committee diligence, meeting frequency has been generally considered as an essential component of audit committee effectiveness. Some studies find the negative relationship between meeting frequency and the occurrence of fraudulent financial reporting (Abbott et al (2000), Beasley (1996)). Some other studies, such as Abbott, Parker, and Peters (2002), link the meeting numbers with higher audit quality, and conclude that audit committee that meet at least four times per year exhibit a significant and negative association with the occurrence of financial reporting restatements. In conclusion, a

plenty of empirical results support the assertion that the meeting frequency of audit committee is positively associated with financial reporting quality.

Inaam, Fatma and Khmouss (2012) conducted a study of the effects of audit committee characteristics (independence, size, meetings and financial literacy), on real activities manipulation in the Tunisian context. The study use secondary data of 29 non – financial firms for a period of 2000 - 2010 and the study made the following finding: audit committee independence seem to be efficient in constraining real earnings management and managers opportunistic behavior; there was no significant association between audit committee expertise and sales manipulation and no significant relation between audit committee expertise and over production; that the more audit committee meeting the better opportunity to detect sales manipulation; and lastly, find that an audit committee size is positively associated with sales manipulation and over production.

Dabor and Adeyemi (2009), conducted a study on corporate governance and the credibility of financial statements in Nigeria, the study examined the relationship between corporate governance and the credibility of financial reports in Nigeria using multiple regression. The study find that in the absence of CEO duality, the financial statements produced appear to be credible and lastly, stated that companies having audit committee as stipulated by CAMA 90 seems to produce credible financial statements.

Abbot, et al (2001), examined the association between audit committee characteristics and audit fees in Texas U.S.A. The study find that independent and

active audit committee demand a high level of audit quality due to concerns about monetary or reputational losses arising from financial misstatement and lastly, document that audit committee comprised solely of independent directors that meet at least 4 times annually are significantly positively associated with audit fees.

Abbot, Parker and Peters (2002), in a study audit committee characteristics and financial misstatement, the study address the impact of certain audit committee characteristics identified by BRC on improving the effectiveness of corporate audit committee on the likelihood of financial misstatements. The study finds that, an audit committee that lacks a member with financial expertise is significantly associated with financial misstatement. And find an audit committee that comprised entirely of independent directors on the audit committee and whether the committee meets at least 4 times per year exhibit significant negative association with the occurrence of financial reporting restatement.

2.5.4 Managerial Ownership and Earnings Quality

While having independent directors appear to be critical to the effectiveness of the Boards' monitoring function, the extent of management ownership may affect control over the board. Jensen and Meckling (1976) theorized that as management ownership increases, their interests will be more closely aligned with owners and the need for intense monitoring by the board would decrease. Bathala

and Rao (1995) argued that the role of outside board members is less critical for firms with higher proportion of inside ownership. They find an inverse relationship between the proportion of outside board members and inside ownership of equity of 261 US listed firms which suggest that higher proportions of insider ownership held by inside board members help to closely align the managerial and shareholder interests, thus, reduce the need for intense monitoring from external board members.

Managers with high ownership interest in the firm are less likely to alter earnings for short term private gains at the expense of outside shareholders. Managers whose interest is consistent with shareholders are more likely to report earnings that reflect the underlying economic value of the firm (Shehu 2011).

The level of managerial ownership affects both the informativeness of earnings and the magnitude of discretionary accounting accruals. Results from empirical works shows that managerial ownership is positively associated with earnings explanatory power for returns. For example, managerial ownership could have negative effect on earnings management (Warfield et al, 1995) or a positive effect due to entrenchment or expropriation effects (Cheng & Warfield, 2005). The analysis of Salsiah et al, (2008) also showed that managerial ownership is negatively associated with the magnitude of accounting accruals after examining the association between the level of managerial ownership and earnings management activities. Sandra (2012) in her research documented that, in all models, the managerial ownership is significantly negatively related with earnings

management which is consistent with the alignment of interest hypothesis, the negative relationship suggests that the higher managerial ownership, the lower the magnitude of discretionary accounting accruals.

Form another dimension, other researchers documented that managerial ownership has no significant effect on increasing the integrity of the financial reporting (Abd Al Nasser, 2012), in the same vein, Hafiza & Susela (2005) in their study fail to find any significant association between managerial ownership and earnings quality. Also, Isenmila and Elijah (2012) in their research observed that managerial ownership is positive and statistically significant at 5% level. When there is little separation between owners and managers, management face less pressure from capital market to signal the firm value to the market and they pay less attention to the short-term financing report (Jensen. 1986) therefore, highly invested managers are more likely to manipulate earnings, since this lack of market discipline may lead insiders to make accounting choices that reflect personal motives rather than firm economies. In this situation, the entrenchment hypothesis states that high levels of insider ownership can become ineffective in aligning insiders to take value maximizing decisions, which may lead to earnings management to increase (Morck et al, 1988). In his findings, Beasley (1996) concludes that higher level of ownership held by outside directors do help reduce the likelihood of financial statement fraud showing a significantly negative relationship.

2.6 Theoretical framework

Theoretical frame serves as guide in selecting theory that underpin the study. For the purpose of this study the agency theory and stake holder theory are discussed

2.6.1 Agency Theory

An agent is somebody who officially represents somebody else in business. In practice the two persons; the one who represents and the one that is represented are referred to as the principal/ owner and agent/manager. The agent is expected to represent the owner. An agency relationship is one in which the principal party makes use of the second party for the purpose of utilizing the specialized skills or knowledge of the second party (Gomez-Mejia & Balkin, 1992). Literature dealing with the moral hazard associated with the inequitable distribution of information in the principal-agent relationship was explored in the 1960s and 1970s under the label of risk sharing (Holmstrom 1979; Wilson 1968) in McCabe, (2002)

McCabe (2002) states that the adaptation of agency theory, grounded in positivism, was a further reinforcement of the scientific management approach, she went further to quote Eisenhardt (1989:25) as he describe agency theory thus;

> From its roots of economics, agency theory has developed along two lines positivism & principal agent… Positive researchers have focused on identifying situations in which the principal & agent are likely to have conflicting goals & then describing the governance mechanisms that limit the agents self serving behavior.

The activities of two parties, agent and principal, are usually with common but differing goals and attitudes towards risk. This is captured in areas such as compensation, ownership structure & financial structure as well as board relationships**,** (McCabet, 2002). However, Berle & Means (1932), describe management of corporation as a set of agents running a business for set of owner. Thus there is implication for both management and board of directors. The BOD are viewed as the agent for shareholders acting on their behalf in their dealing with management. Never -the -less, with effective power vested on management the board was relegated to the role of a quiescent rubber stamp (Berle & Means 1932). The CG variables adopted by this study include, board composition, institutional ownership, managerial ownership and audit committee. While the agency theory deals with the agents and principal and aims at regulating the popular agency problems. The agency model posits that agency problem can be mitigated by incentivizing the agents who have a fiduciary relationship with the principals. Further it is also assumed that the market for corporate control will discipline managers through takeovers/ managers which may force managers which may force managers which may force managers to align their interest with those of shareholders to avoid a hostile takeover and possible loss of jobs.

2.6.2 Stakeholders theory

The term stakeholder was originally used to describe the stockholder as the only group to whom management needed to be accountable (Freeman, 1983). Consequently, the current use of the word includes all those who have a stake

objective of the company (Sternberg, 1997). This has resulted in the theory being adopted or refuted by a range of disciplines forming the business context, (McCabe, 2002). Freeman (1984) seminar work forms the break with established thinking of the stakeholder theory. Rowler (1997) refers to stakeholder theory as a `handmaiden theory` whose concept are used to support the arguments for other theories he concludes by claiming that there is evidence of stakeholder concept in orthodox theories of system theorist and corporate planners.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This study examines the effect of Corporate Governance mechanisms on the earnings quality of listed manufacturing companies in Nigeria. In accordance with this objective, this chapter discusses the research design, methods of data collection, population and sampling, techniques of data analysis employed in the research and measurement of variables.

3.2 Research Design

For this study, correlational research design is used. A correlational research design is used to describe the statistical association between two or more variables. It is therefore, most appropriate for this study because it allows for testing of expected relationships between and among the variables and the making of predictions regarding these relationships. This study involves the measurement of four independent variables and one dependent variable as well as assessment of the relationship between them.

3.3 Population and Sample of the Study

The population of the study comprises of all 56 quoted manufacturing firms in the Nigerian Stock Exchange as at 31st December 2011 which are classified into 4 subsectors namely the foods and beverages, Building Materials, chemicals and paints and Conglomerates. In view of the nature of the model used in the study, a

filter is employed to eliminate some of the firms that have no complete records of all the data needed for measuring the variables of the study within the period (2006-2011). Consequently, 31 firms are eliminated leaving 25 firms representing 45% of the population.

3.4 Sources of data and Methods of Data Collection

The study used panel data all from secondary sources because all the data needed for analysis was adequately and conveniently extracted from the audited financial reports of the selected firms within the period of the study. These financial reports are obtained from Nigerian Stock Exchange Fact Books.

3.5.1 Techniques of Data Analysis

The common techniques for analysis that are used in research are many but for the purpose of this research work, multiple regression is adopted to ESTIMATE the model of the study. Panel data is used to account for individual heterogeneity of the sample companies. Two steps regression is used in determining the quality of financial reports of the Nigerian listed manufacturing firms adopting Francis, LaFond, Olsson and Schipper (2005) model. The residuals for the model after inserting the sampled firms' data represent financial reporting quality in the second regression model specified for the study. However, the residual determines the accrual quality, the larger the residuals, the lower the quality of accruals vice versa.

3.5.2 Variable Measurement

The dependent and independent variables in this study are measured as follows:

i. Earnings Quality

To measure the accounting quality of the firms under study in the sample, the Discretionary Accounting Accruals (DAA) used by management was chosen. Based on this view, the higher the level of DAC, the greater the distance between the economic performance and results shown in the financial statements. Thus, the higher the earning quality the lower the quality of the financial information presented by the firm.

Accounting information quality is an elusive concept in the accounting literature. Consequently, there is little agreement among researchers about how best to measure accounting information quality (Dechow et al, 1995). The scarcity of readily available data in an international setting further complicates this issue. As a result, this study relies on the accruals quality of the Nigerian quoted manufacturing firms using Francis, *et al* (2005) model.

Thus, residuals of $DAA_{it} = \beta_0 + \beta_1 CFO_{it-1} + \beta_2 CFO_{it} + \beta_3 CFO_{it+1} + \beta_4 \Delta REV_{it} + \beta_5 PPE_{it} + \varepsilon$.

DAA_{it} = *Discretionary Accounting Accruals*

β_0 = *Constant*

$\beta_1 CFO_{it-1}$ = *Previous Cash Flow from Operation*

$\beta_2 CFO$ = *Present Cash Flow from Operation*

$\beta_3 CFO_{it+1}$ = *Future Cash from Operation*

$\beta_4 \Delta REV_{it}$ = *Change in Revenue at time t*

$\beta_5 PPE_{it}$ = *Plant Property and Equipment*

ε. = *Error term*

The choice of Francis *et al.* (2005) model among others is informed by the reason that the earnings quality measure derived from earlier prominent models of Jones (1991) as modified by Dechew and Dechev, (2002) can be improved by controlling for two important determinants of accruals, viz., growth in revenues and the level of property, plant and equipment.

ii. Independent Variables

S/No	Variable	Measurement
i.	Board Structure	Measured by the proportion of independent or non-executive directors on the board, expressed in percentage.
ii.	Institutional Shareholding	Measured using proportion of shares owned by institutional investors to total number of shares issued, expressed in percentage.
iii.	Managerial Shareholding	Measured by the ratio of share owned by managers to total number of shares issued, expressed in percentage.
iv.	Audit Committee	Using Governance Score.

CHAPTER FOUR
DATA PRESENTATION AND ANALYSIS

4.1 Introduction

The chapter starts with the analysis of descriptive statistics. It is followed by the presentation of the results of the model estimations and the inferences drawn from the tests of the hypotheses. In addition, findings are analysed and policy implications are discussed. The chapter concludes with a discussion of the robustness of the results for variables of the study.

4.2 Descriptive Statistics

The sample descriptive statistics is first presented in Table 4.1 where minimum, maximum, mean, standard deviation, skewness and kurtosis of the data for the variables used in the study are captured.

Table 4.1: Descriptive Statistics of the variables

Var.	**Min.**	**Max.**	**Mean**	**Std. Dev.**	**Skewness**	**Kurtosis**
	Stat.	Stat.	Stat.	Stat.	Stat.	Stat
EQ	.01	.44	.494	.5364	.262	.958
BC	11.07	72.98	19.5524	7.11594	.465	.339
IS	.10	.93	.4378	.20876	.155	-.899
MS	.10	.55	.2656	.11331	-.002	-1.040
AC	.10	.86	.2747	.11711	.063	.630

Source: spss out put result

Table 4.1 presents the descriptive statistics for the dependent and independent variables respectively (EQ = Earnings quality, BC = Board Composition, IS = Institutional Shareholding, MS = Managerial Shareholding, and AC = Audit Committee). Most prominent result is the high standard deviations of independent directors (7.12) relative to the standard deviations of other variables included in the model of the study which ranges between 0.11 to 0.53 which may indicate that our sample firms are of different sizes and maturity. This is supported by the highest average value of 19.55. However, institutional shareholders represent 44% of shareholders on average. This indicates that majority of the share holders representing 66% in the Nigerian manufacturing firms are individuals. This statistic is not surprising due to the nature of Nigerian Stock Exchange market which is an emerging one. Thus, most of the listed firms are owned and controlled by individuals rather than institutional investors. The average shares held by managers in the Nigerian manufacturing firms is about 27% with a minimum and maximum of 10 and 55 percent respectively. Finally, the skewness and kurtosis statistics reveal that data obtained for all the variables including dependent and independents are not abnormal. This signifies the normality of the data and substantiates the validity of the regression results.

4.2.1 Correlation Matrix

The correlation matrix for the explained and explanatory variables are analysed and presented in Table 4.2.

Table 4.2: Correlation matrix

Var.	Statistics	EQ	BC	IS	MS	AC
EQ	Pearson Corr.	1				
	Sig. (2-tailed)					
BC	Pearson Corr.	.654**	1			
	Sig. (2-tailed)	.000				
IS	Pearson Corr.	-.554	.149	1		
	Sig. (2-tailed)	.547	.098			
MS	Pearson Corr.	.308**	.213*	-.031	1	
	Sig. (2-tailed)	.000	.017	.728		
AC	Pearson Corr.	.553**	.621**	.024	.155	1
	Sig. (2-tailed)	.000	.000	.794	.085	

Source: SPSS Output Result

**.Correlation is significant at the 0.01 level (2-tailed).*
** Correlation is significant at the 0.05 level (2-tailed).*

Table 4.2 shows the correlation matrix with the top values containing the Pearson correlation coefficient between all pairs of variables and the bottom values containing two-tail significance of these coefficients. Checking the pattern of relationships between dependent and independent variables, it is observed that the variables correlate perfectly well (between 0.31 and 0.65) and significant at either 1 or 5 percent. Thus, there is no correlation coefficient particularly large (greater than 0.7) and there is no significant value less than 0.05. On the other hand, the relationships between most of the explanatory variables are minimal, insignificant

and negligible. Hence there is no problem of singularity of data. Therefore, multicollinearity is not expected to pose a problem to the result of the study.

4.3 Presentation and Discussion of Regression Results

This section presents the regression result of the dependent variable (EQ) and the independent variables of the study. It follows with Discussion of the association between dependent variable and each independent variable individually and cumulatively. The summary of the regression result obtained from the model of the study ***(EQ = β_0+ β_1BCOMP+β_2IS+ β_3MS+ β_4AC+e)*** is presented in Table 4.3.

Table 4.3: Regression Results

Statistics / **Variables**	**Beta Coefficients**	**t-values**	**Sig.**
Board Composition.	-0.504*	-5.994	0.000
Institutional Shareholding	-0.129**	-1.984	0.050
Managerial Shareholding	-0.163**	-2.473	0.015
Audit Committee	-0.218*	-2.653	0.009
R			**0.712**
R^2			**0.507**
Adj R^2			**0.491**
F. Statistic			**30.878**
F-Sig.			**0.000**
Durbin-Watson			**1.747**

Source: SPSS Output Result

The cumulative correlation between dependent variable and all the independent variables is 0.71 indicating that the relationship between Corporate Governance mechanisms and Earnings Quality used in this study is 71% which is positively, strongly and statistically significant. This implies that for any changes in CG of Nigerian listed manufacturing companies; their earnings quality will be directly affected. Thus, CG p

Plays a significance role in controlling EQ in the Nigeria Manufacturing Sector.

The R^2 (0.51) which is the coefficient of determination gives the proportion or percentage of the total variation in the dependent variable explained by the explanatory variables jointly. Hence, it signifies 51% of total variation in EQ of Nigerian listed manufacturing companies is caused by their CG mechanisms of board composition, institutional shareholding, managerial shareholding and audit committee. This indicates that the model is fit and the explanatory variables are properly selected, combined and used. The Durbin-Watson tests of first order auto-correlation (1.75) indicate that errors are uncorrelated to each other indicating absence of serial correlation within the period of the study.

4.3.1 Board Composition and Earnings Quality

The regression result reveals that independent directors as measured by the proportion of independent or non-executive directors on the board are negatively related and statistically significant at 1% level of significance with EQ. This implies that the independent directors are free from managerial influence and capable of monitoring them efficiently which improves the quality of financial information conveyed to the users of financial statement in the Nigerian manufacturing companies. In addition, this study finds that the increase in the percentage of independent directors in the board reduces unethical accounting which has a positive role in determining the quality of earnings of Nigerian manufacturing companies. This may be as a result of outside members do not play a direct role in

the management of the company; their existence may provide an effective monitoring tool to the board and thus reduces earnings management by managers which produces higher quality of financial reports. This result produced an evidence of rejecting hypothesis one of the study which state that board composition has no significant impact on the earnings quality of Nigerian manufacturing companies. This findings is in line with Fama and Jensen (1983) and Hannifa and Cooke (2002), and contrary to Smith (1976), Bhagat and Black (1999) and Abdullah and Mohammed (2004).

4.3.2 Institutional Shareholding and Earnings Quality

Looking at the relation between institutional shareholding and earnings quality, a negatively association emerged and it has been supported statistically at 5% level of significant. This significant association indicates that institutional investors are one of the major considerers in managers' aggressive earnings management strategy. This result is not surprising despite the fact that the descriptive statistics shows that the individual ownership is greater than the institutional ownership. In Nigeria, most institutional owners are social security institution (government pension funds) and financial firms. As a result, institutional investors in Nigeria are effective in constraining managerial behaviour of earnings management through abusive accounting, income manipulations and smoothening or unethical accounting. Consistent with the argument that institutional investors in Nigeria are short-term oriented and create incentives for managers of their portfolio firms to manage earnings aggressively, these institutional investors focus

excessively on current earnings performance. Substantial institutional presence acts as a deterrent to a firm's accrual management activity. Institutional investors are, therefore, found to improve corporate governance by providing monitoring on the corporate financial reporting process. This result produced an evidence of rejecting hypothesis two of the study which states that institutional shareholding has no significant impact on the earnings quality of Nigerian manufacturing companies. The findings supported Cleassen and Fan (2002) Hashim and Devi (2003) and contradicts the findings of Abdurrahman and Mohammed (2006).

4.3.3 Audit Committee and Earnings Quality

Our regression result reveals that Audit Committee is negatively and statistically significant at 1% level in determining the earnings quality of Nigerian listed manufacturing firms. This implies that audit committee is significantly improving the quality of accounting information in the financial statement. This result may be as a result of controlling power of verifying the accounting figures when executing their responsibility as well as scrutinizing the audited financial statements of their firm. This result produced an evidence of rejecting hypothesis three of the study which states that audit committee has no significant impact on the earnings quality of Nigerian manufacturing companies. The finding is in line with those of Levitt (1998) and Beasley (1996).

4.3.4 Managerial Shareholding and Earnings Quality

Our expectation is that firms with managers as shareholders have stronger desires and are more likely to manipulate earnings to keep consistent earnings growth trend and meet or beat earnings expectations. The result in respect of managerial shareholding and earnings quality did not prove otherwise as it shows that managerial shareholding is negatively associated with EQ and significant at 5% in explaining earnings quality of Nigerian manufacturing firms. This implies that the larger the number of shareholders in the management of Nigerian manufacturing firms, the less reliable and qualitative accounting information will be in their financial statements. This result may be as a result of managers holding shares may face more pressure to report positive earnings for their personal interest and performance appraisal because they have higher abilities to maneuver given wide range of accounting treatments available, and have stronger management power to make it easier to manipulate earnings. This result produced an evidence of rejecting hypothesis four of the study which states that managerial shareholders have no significant impact on the earnings quality of Nigerian manufacturing companies. The findings supported Jensen and Mecklings (1976) and contradicts Beasley (1996).

4.4 Robustness Test

This section presents robustness checks applied to examine the results of the study. The robustness outcomes relative to the original results provide greater credibility to the overall findings of the study.

Table 4.4: Multicollinearity Test

Variables	Tolerance	VIF
Board Composition	0.342	2.925
Institutional Shareholding	0.968	1.033
Managerial Shareholding	0.917	1.091
Audit Committee	0.485	2.060

Source: STATA and SPSS output

4.4.1 Robustness Test of Independent and dependent Variables

This section present the results of robustness tests conducted in order to improve the validity of all statistical inferences for the study. These tests include; multicollinearity test, heteroscedasticity test, cross-sectional dependence test, test of serial correlation, Hausman specification test and histogram of residuals test.

i. **Multicollinearity test:** This is to check whether there is a strong correlation between independent variables which will mislead the result of the study. Table 4.4 presents the matrix of the linear relationships among the continuous independent variables. To formally substantiate the lack of multicollinearity between the independent variables, colinearity diagnostics are observed and that the variance inflation factors (VIF) and tolerance inflation values (TIV) indicate no multicollinearity between the data variables. The values for TIV and VIF are shown in Table 4.4. The TIV and the (VIF) are two advanced measures of testing the presence of multicollinearity between the independent variables. Using SPSS, the VIF and TIV are computed and found to be consistently smaller than ten and one

respectively indicating absence of multicollinearity (Neter, Kutner, Nachtsheim, and Wasserman, 1996 and Casey and Anderson 1999) as cited in Shehu (2012). This shows the appropriateness of the fitness of the model of the study with the four independent variables. In addition, the tolerance values are consistently smaller than 1.00 thus further substantiates the fact that there is no multicollinearity between independent variables (Tobachnick, and Fidell, 1996).

ii. **Test of serial correlation:** Auto correlation causes the standard errors of the coefficient to be smaller than they suppose to be and higher R^2. This will mislead the interpretation of impact or effect and fitness of the model used in the study. Apart from Durbin-Watson statistic used earlier, a Wooldridge test for serial correlation has been conducted which confirmed the earlier position that no serial correlation within the observations of the panel. Thus, the probability of F- statistic is not significant.

iii. **Normality Test of Dependent Variable:** The histogram of residuals test is considered for this work because it measures the normality of regression residuals which is the proxy of dependent variable in the regression model of this study. A histogram of residuals is a simple graphic device that is used to learn something about the shape of the Probability Distribution Function (PDF) of a random variable. This test is selected because the values that will represent earning quality in the model of the study are in residuals not absolute values.

iv. **Heteroscedasticity and cross – sectional dependence tests.** This confirms that, the data is homodastic in nature which allows use of ordinary least square when regressing explained and explanting variables of the study.

4.5 Implications of the findings

The study has several theoretical, political, policy and regulatory implications. These implications represent the contributions of the study which are expected to benefit the existing body of knowledge within the accounting research, regulators and providers of accounting services as well as the entire accounting profession in general.

The findings have important policy implications since they suggest the need to encourage applying CG principles by institutions and individual block-holders to provide effective monitoring of earnings management in Nigerian listed manufacturing companies. These firms operate in the business environment of individual ownership domination and control, where managers have greater motivation and opportunity to manage earnings to maximize their private benefits. This suggests that similar efforts in other sectors especially financial institutions would be rewarding in controlling the management of reported earnings, to enhance the reliability and transparency of reported earnings and promoting economic efficiency.

The analysis reveals that board composition is positively and significantly influencing EQ. This implies that independent directors play a prominent role of monitoring management to reduce their opportunistic behavior in managing earnings. This implication provides some support to the emergent critique of the independence vogue and the critique foreshadows public opinion pressures (by institutional investors, regulators and the analyst) that have led quoted firms to

include too many independent members in their boards. However, the advocacy by institutional investors, policy advisors and the business media for greater non-executive independence may be too crude or even counter-productive. Therefore, their much delusion in the board is highly beneficial and promising.

Furthermore, the effect of directors' independence on earnings quality of firms as showed by empirical evidence may have significant policy implications for the composition of the board of directors. First of all, as already mentioned, parties that have long-term relationships with the firm as a going concern are natural candidates. As such, grey or affiliated directors; employees, block-holders to mention but a few may be highly valuable and their very position allows cognitive advantages over purely independent directors.

The above findings may have implications for users of financial statements and regulatory bodies. In particular, financial statement users should be aware of income smoothing and the factors affecting such behavior when they rely on financial statements to help them make decisions. Specifically, users should note the influence of the independent or non-executive directors, institutional shareholdings and the audit committee on such behavior. Further, since extensive unethical accounting may lead to inadequate or misleading income disclosure, thus regulators should concentrate their efforts where unethical accounting is most likely and most extensively to happen. Which will go a long way in improving the policies by the board of directors of the manufacturing companies.

Finally, the findings shed more light on CG and EQ studies in the sense that earnings management practices are not attributed to few firms; rather it is a widespread phenomenon in Nigeria. The standard setters should enhance the credibility of financial reporting is achieved, our evidence on a widespread earnings management practices in respect to board composition, institutional shareholding, managerial shareholding and audit committee may give a warning. To ensure that unethical accounting is not encouraged, standard setters may consider adjust policy for disclosure or request additional disclosures from firms in associating discretionary activities. Further, investors may caution in defining high quality earnings firm. CG mechanisms may help them to predict potential earnings management firms.

CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The study investigates effect of corporate governance mechanisms on the earnings quality of quoted manufacturing firms in Nigeria. It has developed a multiple regression model for the purpose of explaining and predicting empirically the earnings quality behaviour as a result of changes in corporate governance mechanisms. The developed model of the study estimates the relationship and effect of four explanatory variables – board composition, institutional shareholding, and managerial shareholding and audit committee on one explained variable – earnings quality by means of the least square technique.

The study is predicated on the premise that managers of firms use their discretion by exercising unethical accounting to satisfy personal interest at the detriment of their firms. Therefore, the study reveals the role corporate governance mechanisms play in determining the level of manipulative accounting by the managers.

The findings of this work are based on the balanced panel data collected for the period 2006 -2011 from a sample of 25out of 56 quoted manufacturing firms on the Nigerian Stock Exchange. The results of the study reveals that all the explanatory variables are negatively and strongly significant in explaining the earnings quality of the sample firms. In addition, all the independent variables have significant aggregate effect at one percent level on the dependent variable of the study. Thus, corporate governance used in this study proved to be the major

determinants of earnings quality through monitoring management in checking unethical accounting.

5.2 Conclusions

Based on the findings of the research, the study concludes as follows:

Firstly, the study has provided both empirical as well as statistical evidence on the utility of four independent variables that constitute corporate governance mechanisms board composition, institutional shareholding, managerial shareholding and audit committee in explaining and predicting earnings quality of the sample firms.

Secondly, independent directors play a prominent role of monitoring management to reduce their opportunistic behavior in managing earnings. Therefore, the presence of higher proportion of independent members on corporate board is likely to enhance the earnings quality reported by the firms. Thus, efficient monitoring from non-executive directors that are free from managerial influence is capable to improve the quality of financial information conveyed to the user of financial statement. As is the case with the upper limit of the size of the board of directors, there is also a maximum level of independence of the board, from which the virtues of independence no longer apply.

Thirdly, institutional investors as one of the factors that constrain managers' ability and influence their choice to manage earnings, their substantial institutional presence reduces the level of earnings management by inhibiting

managers to use questionable accounting techniques to manage accruals. In this sense, institutional investors improve the quality of corporate governance and that of financial reporting.

Finally, the quantum of shares held by managers should be reduced in order to minimize unethical accounting and improve the quality of earnings. The presence of an elaborate audit committee will improve the overall quality of earnings as they play a vital role of internal control mechanism

5.3 Recommendations

The recommendations of this study are proffered as follows:

i. The board of directors in Nigerian manufacturing firms should be composed in such a way as to ensure diversity of experience without compromising, compatibility, integrity, availability and independence. The members of the board should be individuals with upright personal characteristics and relevant core competences, preferably with a record of tangible achievement, knowledge on board matters, a science of accountability, commitment to the task of corporate governance and institution building as well as having an entrepreneurial bias to enable them check made the unethical accounting of management.

ii. To discourage shareholder activism weather by institutional shareholder or by organise shareholders group. Shareholders with larger holdings (institutional and non institutional) should act and influence the standard of corporate governance positively which optimises stakeholder value and improve earnings quality, thus the

institutional shareholders should be encouraged to invest. This will increase the monitoring capability of institutional shareholders toward unethical accounting of management and improve earnings quality.

iii. In the case of managerial shareholding, the shareholders should reduce the quantum of shares owned by managers and restrict them from buying more in order to reduce their overall ownership of their shares. This will go a long way in reducing unethical accounting and improving the quality of earnings in the Nigerian quoted manufacturing firms.

iv. The composition of audit committee should be made in accordance with the provision of code of corporate governance; not more than six (6) members with at least one (1) financial expert. The committee should hold meetings at least three times in a year. In addition, the members of the audit committee should be people of integrity and experience and meet not less than four times per annum as provided by the code. All these will play a prominent role and strengthen the audit committee to enable them check mate the unethical accounting activities by the managers in preparing financial statements and improve the quality of accounting numbers.

5.4 Limitations of the Study

Like any other research, the result of this study is subject to some limitations due to the following factors:

Due to the nature of the study which focuses on examining accruals, Firstly, the sample excluded companies from banking and insurance sector. Secondly the

manufacturings companies were chosen on information availability basis rather than on random selection, this plays an important role in determining the generalisability of the results. The result is a reduction in the size of the sample and the ability to generalise the results across populations, settings and times enhances the external validity of the study.

5.5 Future Research

This research work examines corporate governance and Earnings quality of Nigerian quoted manufacturing firms and has paved the way for further research in the following areas.

1. The same research can be replicated using firms such as insurance firms, small and medium enterprise (SMEs).

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Appendix A: Population of the Study

	Subsectors	Firm
1	Building Materials	Ashaka Cement Plc.
2	Building Materials	Cement Co. of Northern Nigeria Plc.
3	Building Materials	Nigerian Wire PLC.
4	Building Materials	Lafarge Plc
5	Building Materials	Dangote Cement Plc
6	Building Materials	WAPCO PLC.
7	Building Materials	CUTIX PLC
8	Building Materials	First Alluminium Nig PLC.
9	Building Materials	DNMRYER PLC
10	Building Materials	BETAGLASS CO PLC.
11	Chemical and Paints	DN Meyer PLC.
12	Chemical and Paints	CAP PLC
13	Chemical and Paints	Berger Paints PLC
14	Chemical and Paints	Chemicals & Allied Products
15	Chemical and Paints	Ipwa PLC
16	Chemical and Paints	Premier Paint PLC
17	Chemical and Paints	Afri Paints PLC
18	Chemical and Paints	May and Baker PLC
19	Chemical and Paints	Paints and Coatings Man. PLC
20	Chemical and Paints	Portland Paints and Products PLC
21	Chemical and Paints	Nigerian German Chemicals
22	Conglomerate	A.G. Leventis (Nigeria) Plc
23	Conglomerate	Chellarams Plc
24	Conglomerate	John Holt Plc.
25	Conglomerate	P Z industries Plc.
26	Conglomerate	SCOA Nigeria Plc.
27	Conglomerate	UAC of Nigeria Plc.
28	Conglomerate	Unilever Nigeria
29	Conglomerate	Transnational Corporation PLC
30	Conglomerate	Transnational Corporation PLC
31	Conglomerate	Transnational Corporation PLC
32	Conglomerate	Dangote Group.
33	Food/Beverages & Tobacco	7up Bottling Co Plc
34	Food/Beverages & Tobacco	Coca-cola Nig. Plc
35	Food/Beverages & Tobacco	British Tobacco Nig. Plc
36	Food/Beverages & Tobacco	Dangote Flour Mills Plc
37	Food/Beverages & Tobacco	Dangote Sugar Refining PLC
38	Food/Beverages & Tobacco	May and Baker Plc
39	Food/Beverages & Tobacco	VITAFOAM Nig PLC
40	Food/Beverages & Tobacco	VONO PLC
41	Food/Beverages & Tobacco	Guinness Nig PLC
42	Food/Beverages & Tobacco	Nigerian breweries Plc

43	Food/Beverages & Tobacco	Premier Brew.
44	Food/Beverages & Tobacco	Flour Mills Nigeria Plc
45	Food/Beverages & Tobacco	Nestle Nigeria Plc
46	Food/Beverages & Tobacco	Nigerian Bottling Company Plc
47	Food/Beverages & Tobacco	UTC Nigeria Plc
48	Food/Beverages & Tobacco	P.S. Mandrides & Co Plc
49	Food/Beverages & Tobacco	Union Dicon Salt Plc
50	Food/Beverages & Tobacco	Cadbury Plc.
51	Food/Beverages & Tobacco	National Salt Co. Nig. Plc
52	Food/Beverages & Tobacco	Honeywell Flour Mill Plc
53	Food/Beverages & Tobacco	Tate Industries Plc
54	Food/Beverages & Tobacco	Northern Nigeria Flour Mills Plc
55	Food/Beverages & Tobacco	Big Treat Plc
56	Food/Beverages & Tobacco	Tantalizers Plc

Appendix B: Sample of the Study

	Subsectors	Firm
1	Building Materials	Ashaka Cement Plc.
2	Building Materials	Cement Co. of Northern Nigeria Plc.
3	Building Materials	Lafarge Plc
4	Building Materials	WAPCO PLC.
5	Chemical and Paints	DN Meyer PLC.
6	Chemical and Paints	Berger Paints PLC
7	Chemical and Paints	Chemicals & Allied Products
8	Chemical and Paints	Ipwa PLC
9	Chemical and Paints	Premier Paint PLC
10	Conglomerate	A.G. Leventis (Nigeria) Plc
11	Conglomerate	John Holt Plc.
12	Conglomerate	P Z industries Plc.
13	Conglomerate	SCOA Nigeria Plc..
14	Conglomerate	Unilever Nigeria
15	Conglomerate	Transnational Corporation PLC
16	Food/Beverages & Tobacco	Seven-Up Bottling Co Plc
17	Food/Beverages & Tobacco	Flour Mills Nigeria Plc
18	Food/Beverages & Tobacco	Nestle Nigeria Plc
19	Food/Beverages & Tobacco	UTC Nigeria Plc
20	Food/Beverages & Tobacco	P.S. Mandrides & Co Plc
21	Food/Beverages & Tobacco	Union Dicon Salt Plc
22	Food/Beverages & Tobacco	Cadbury Plc
23	Food/Beverages & Tobacco	National Salt Co. Nig. Plc
24	Food/Beverages & Tobacco	Northern Nigeria Flour mill Plc
25	Food/Beverages & Tobacco	Coca-Cola Nig. Plc.