

**BOARD SUPERVISION AND EARNINGS  
QUALITY OF LISTED CONGLOMERATE FIRMS  
IN NIGERIA**

BY

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## DECLARATION

I declare that the work in this dissertation entitled “**Board Supervision and Earnings Quality of Listed Conglomerate Firms in Nigeria**” has been performed by me in the Department of Accounting. The information derived from the literature has been duly acknowledged in the text and a list of references provided. No part of this dissertation was previously presented for another degree or diploma at this or anyother institution.

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## CERTIFICATION

This dissertation titled “**Board Supervision and Earnings Quality of Listed Conglomerate Firms in Nigeria**” conducted by Alhaji UMAR meets the regulations governing the award of the Degree of Master of Science in Accounting and Finance (M.Sc.) of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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## **DEDICATION**

This dissertation is dedicated to Almighty ALLAH the source of all wisdom and knowledge.

## ACKNOWLEDGEMENTS

All praises and gratitude are due to Almighty Allah (the Most Exalted) who in His infinite mercy has spared my life up to this moment. I thank Him for His guidance and protection throughout this programme. May peace and blessings of Allah be upon our beloved and noble Prophet Muhammad (PBUH), His household, His companions, and all those that seek and follow His guidance till the last day. May peace and blessings of Allah also be upon all other Prophets, Amen.

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## **ABSTRACT**

A major motivation for accounting research is providing evidence on how earnings are useful to a wide range of users in making economic decisions. Of particular interest over the last decade has been the issue of the quality of accounting reports, particularly the quality of earnings. This study examines Board Supervision and Earnings Quality of Listed Conglomerate Firms in Nigeria Stock Exchange (NSE) with a view to determine how board size, proportion of non-executive directors and number of board meetings have significant impact on earnings quality of the conglomerate firms under study. Correlation research design is used for the study and data is collected from six (6) conglomerate companies listed in the NSE daily official list as at 31 December 2012 from the firms' official website and facts books. The study covers periods 2006 – 2013. Multiple regression analysis was used as technique for analysis. All output are obtained using STATA 10 statistical package. The findings indicated that a positive relationship between Board size and earnings quality and significant at 5% level of significance. The relationship between proportions of Non-Executive and number of board meetings is positive but insignificant. The study was able to establish the overall significance relationship of the three variables with earnings quality. The study therefore, recommends an increase in Board size of the conglomerate firms so as to strengthen supervision and increased earnings quality. Also, an increase in the proportion of non – Executive Directors will enhance effective board supervision thereby leading to a higher earnings quality. Frequent meetings of the board will create immediate forum for removing gray areas that may affect supervision and earnings quality.

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background to the Study

Earnings quality and the quality of financial reporting in general are subjects that have attracted much attention and are the centre of debate for investors, regulators as well as scholars in the recent years. This heightened attention to the subject of earnings quality is, in part, due to the wave of accounting scandals of the early 2000s (the manipulation of accounting figures) (Hermanns, 2006). However, earnings quality has been a topic of increasing importance and interest especially after the colossal corporate collapses of Enron, WorldCom, Parmalat and, more specifically, Leisurennet and Fidentia in South Africa amongst others, which has put a big question mark on the financial reporting quality of the publicly listed companies in stock market (Abdullah, 2004).

Earnings quality is of interest to users of financial statements because earnings and the varied metrics derived there from are utilized in making contracting and investment decisions. From a contracting perspective, low-quality earnings may result in unintended wealth transfers. From an investor's vantage point, low-quality earnings are undesirable because they result in a defective resource allocation signal (Schipper & Vincent, 2003). This is also supported by

Myers, Myers & Omer (2003), who stated that poor quality of earnings is problematic because it can mislead investors, resulting in misallocation of resources. In the recent work of Redhwan, (2014) erosions in earnings quality, transparency, and disclosure levels have caused investors to be less confident in the integrity of accounting numbers. Since investors need unbiased earnings information to make the right investment decisions, financial crises and financial reporting scandals have unveiled the importance of board supervision and highlighted the crucial need for firms to enhance the quality of reported earnings. Earnings quality is an important characteristic of financial reports that affects the efficient allocation of resources (Peter, Baruch, Melissa, & Sarah , 2013).

The generation of quality earnings information depends on a whole set of guarantee mechanisms, for instance, a governance mechanism capable of efficiently supervising the process of accounting information reporting. The board of directors, as the core of corporate governance, will undoubtedly play a key role in supervising listed companies' financial reporting process and the quality of financial reporting. Strengthening the board of directors, such as enhancing the board's independence, improving its capabilities of detecting problems in financial statements, and clarifying explicitly directors' responsibilities, is regarded as an

efficient way to ameliorate the board supervisory and monitoring practices and the quality of financial reporting (Qinghua, Pingxin & Junming, 2007).

Accounting scandals broke out one after another in various enterprises, under the guise of related party transactions, and accounting fraud was perpetrated through benefit transactions between the parent and subsidiary companies, such as Enron and WorldCom in the United States. The occurrence of these major cases exposed the lack of supervising mechanisms in enterprise management and resulted in heavy investor losses. In order to reduce the behavior of surplus manipulation of enterprises and to restore investor confidence and stable operations in the capital markets, the Organization for Economic Cooperation and Development (OECD), the World Bank, and other international organizations advocated supervising mechanisms to strengthen corporate governance effectively. Therefore, the related issue of supervising mechanisms that could enhance the effectiveness of corporate governance gained momentum and received considerable attention in countries around the world, and became an important topic of academic research (Hsiang-tsai, .Li-jen, & Chih-Hung, 2012).

According to Qing, Yuning & Besim-Burcin (2013) When the Management rights and ownership is separated, the prevailing view is that the important function of the board is supervision on behalf of shareholders. The management of a

company should be monitored by the board of directors on behalf of the shareholders. Managers should be accountable to the board, which, in turn, should be accountable to the shareholders, whose task it is to appoint the board of directors (Abor & Adjasi 2007 and Maharaj 2009). To fulfill its monitoring and supervisory role, board members need sufficient expertise and firm specific knowledge. Accounting literature discusses various board characteristics that influence the demand for and characteristics of financial reporting (Nina, 2011). Therefore, there might be a relationship between earnings quality and board supervision to a large extent.

The concept of earnings quality has attracted various definitions over time. The accounting literatures embrace several definitions of earnings quality. Some related to the persistence of earnings others relate to the accurate representation of underlying economic transactions and events. Still other authors consider the relation between accruals and cash flows. Francis et al. (2004) identify seven measures of earnings quality which they characterize as either “accounting-based” or “market-based” depending on the underlying assumptions about the function of financial reporting, and they noted that these assumptions will, in turn, influence the way the attributes are measured. Accounting-based earnings quality measures assume that the function of earnings is to allocate cash flows to reporting periods

via accruals, while market-based earnings quality measures assume that the function of earnings is to reflect economic income as represented by stock returns. While one should anticipate that better board supervision leads to improve earnings quality, there is lack of agreement as to how quality of earnings can be measured (Tabitha, Eunice, & Olaroyeke, 2014).

Mohamed & Aiman (2013) stated that board size is shown as a significant part of the ability of boards to effectively monitor management and to work efficiently together to oversee the running of the business. Board size is an indicator of both its monitoring and advisory roles, both of which may contribute to its oversight into management behavior (Coles, Daniel, & Naveen, 2008). Recently, Redhwan & Ku-Nor (2014) stated that board size is an important element that impacts the effectiveness of board oversight duties. Board size is used as an instrument for two reasons. Firstly, the fraction of independent directors is likely to be smaller for boards with more members (Chen & Al-Najjar 2012). Secondly, firms with larger boards presumably can afford to invite outside directors to their boards without sacrificing representation of the insiders (Agrawal & Knoeber 1996). Several studies use board size as a measure of board quality (Yermack 1996; Cyert et al. 2002; Weber 2006). Larger boards are viewed as having expert board members, especially those who are independent and can

provide environmental links (Redhwan , 2014) which may lead to effective supervision and higher earnings quality.

To be effective, the Cadbury Report (1992), for example, recommends the board to be comprised of majority of non-executive directors who are likely to bring an independent judgment. Non-executive directors effectively monitor firm activities; reduce agency costs; and, hence, improve earnings quality (Fama & Jensen 1983; Jensen & Meckling 1976). Consistent with these assertions, empirical studies conclude that reported earnings quality is enhanced as the proportion of non-executive directors increases (Dimitropoulos & Asteriou 2010 and Sahlan 2011). Another board supervision attributes that has been identified as being relevant to financial reporting is frequency of meeting. Xie, Davidson, & DaDalt, (2003) found a positive relation between board meeting frequency and earnings quality,

Corporate governance refers to the supervision of companies by board of directors and supervisors, the perfection of the shareholding structure, and the enhancement of information transparency (Chiang, 2011). It is one of the most important duties of the board supervision and according to Low, Law, & Ong; (2011) corporate governance to ensure the quality of financial reporting. Sytse & Hein (2013) in their study indicated that corporate governance control mechanisms

are designed to reduce the inefficiencies, an ideal monitoring and control system should regulate both motivation and ability, while providing incentive alignment toward corporate goals and objectives. Therefore, board supervision has linkage with corporate governance.

Each person who reads or hears the word ‘supervision’ interprets it in terms of his past experiences, his needs and his purpose. Supervision means to be in charge of somebody or something and make sure that everything is done correctly, safely and according to the purpose or goals it intends to achieve. The purpose of supervision is to enhance justice, increase transparency, raise accountability, decrease conflict of agency, reduce information asymmetry, better performance, increase corporate value and better the status of shareholders. The board of directors has an important role in overseeing how management serves the long term interests of shareowners and other stakeholders, as well as overseeing the duties of the inside and outside directors (Yi-Hsien, Chung-chu & Shu-yu, 2010).

Generally, a conglomerate is a large company that consists of diverse divisions that produce and sell unrelated goods and services. The Nigerian conglomerate sector comprises of multinational companies engaged in multi-faceted services ranging from manufacturing and sales of foods and personal care products, sales and distribution of automobiles and equipments. The companies

under the sector can be largely divided into two, based on their major areas of focus. The first group is involved mainly in the manufacturing of foods and house care items and the other group comprises of companies that focus on engineering technologies, sales and distribution of automobiles. A listed conglomerate company in Nigeria is a company which is quoted on Nigeria Stock Exchange for the purpose of trading on a regular basis by the investing public. The study considered conglomerates because researches revealed that large-scale multi-faceted earnings management is mostly associated with conglomerates owing to their peculiar structure (Mehta & Srivastavaare, 2009 and Shehu & Jibril, 2012). Also, in emerging markets the conglomerates are considered the main cause of the employment growth rate and economic growth creation.

Existing literature on board supervision and the informativeness of firm's earnings is based mainly on the US and European data and therefore, reflects corporate behavior purely within these markets. Thus, very little is known about the relationship between board supervision and earnings quality, particularly in the smaller markets outside of the U.S., Europe, and certain emerging economies like Nigeria (Ali, Saleh, & Hassan, 2008). In Nigeria, board supervision and earnings quality study seems to have ignored the Impact of Board supervision on Earnings Quality of Listed Conglomerate firms in Nigeria. The archival literature in the

area of earnings quality largely focused on firm-specific characteristics, such as firm size and board independence (Dechow and Dichev 2002; Klein 2002, Demerjian, Lev, Lewis, & McVay, 2013) and Number of meetings held by the board members during the periods. Numerous studies in Western settings have suggested that both firm performance and the informativeness of reported earnings are affected by such BOD attributes (Yermack, 2004; Bédard, Chtourou, & Courteau, 2004; Vafeas, 2005; Srinivasan, 2005). The study focused on this attributes as proxies for board supervision. Accordingly, this study examines the impact of board supervision on earnings quality of listed conglomerate firms in Nigeria with a view to determine how these board attributes such as board size, proportion of non-executive directors and number of board meetings have significant impact on earnings quality of listed conglomerate firms in Nigeria.

This study uses accruals quality, which refers to the extent to which accruals shift or adjust the recognition of cash flows over time so that the adjusted number (earnings) measures firm performance and predicts future earnings and cash flows. This is consistent with previous studies on earnings quality (Van Tendeloo & Vanstraelen, 2005; Chen, et al., 2007; Barth, Landsman, & Lang, 2008)), which often use the term ‘earning quality’ to denote the absence of earnings management, or the absence of income-increasing accrual. We select this measure because we

expect that better board supervisions are able to report accruals that more closely correspond to the underlying economic activity, we expect the earnings quality metrics that are affected by judgments and accrual estimation to vary with board supervision.

## **1.2 Statement of the Problem**

In Nigeria, board supervision and earnings quality study seems to have received very little attention despite a good number of studies on corporate governance and the conglomerate firms particularly after the Nigeria Security and Exchange Commission released its code of corporate governance in 2003. One reason for this inference is the lack of available data and poor access to appropriate databases.

Corporate scandals that occurred world-wide have raised questions about earnings quality and supervisory role of the board of directors. Many researchers are of the view that these corporate failures were caused by inadequate corporate governance, which included lack of oversight from the board of directors (board supervision) and poor strategic decisions (from board meetings) (Li 2009;

Hamilton & Micklewait 2006; Grant & Visconti 2006; Garcia, Osma & Noguer 2007). The majority of these studies have relied on data of listed companies from the US, the UK and to a limited extent, Europe. Despite the importance and empirical findings of these studies it is questionable whether these results can be generalised to other time periods and countries, due to different accounting standards and variation in board oversight requirements at the time.

More so, in Shehu & Jibrin (2012), it is revealed that large-scale multi-faceted low earnings quality is mostly associated with conglomerates firms owing to their peculiar structure (e.g. transfer of profitable or toxic assets to/from the subsidiaries, related party transactions, and so on). This, thus, makes it necessary to investigate the implication and impact of Board Supervision on earnings quality of listed conglomerate firms. This is necessary to avoid its micro and macro effects in form of wrong investment and finance decisions, illiquidity problems and corporate failures.

To the best of our knowledge, we are not aware if board size, percentage of Non-executive Directors and Board meetings, all as a mechanism of board supervision, has significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria. The study is conducted to know whether the same result can be

obtained as with other previous studies using different sector (conglomerate firms) and different time frame. This study therefore, is a modest effort to fill this gap.

### **1.3 Research Questions**

The following research questions are answered empirically;

- i. To what extent does Board Size has significant Impact on Earnings Quality of Listed Conglomerate Firms in Nigeria?
- ii. To what extent does the proportion of Nonexecutive Directors has significant Impact on Earnings Quality of Listed Conglomerate Firms in Nigeria?
- iii. To what extent does the number of Board meetings has significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria?

### **1.4 Objectives of the Study**

The main objective of this study is to assess the impact of Board Supervision on Earnings Quality of Conglomerate Firms in Nigeria with a view to determine the extent to which some tools that aid board supervision has significant impact on earnings quality of listed conglomerate firms in Nigeria. The specific objectives are:

- i. . To ascertain the extent to which Board Size impacts on Earnings Quality of Conglomerate Firms in Nigeria.
- ii. To assess the impact of the Proportion of Nonexecutive Directors on Earnings Quality of Conglomerate Firms in Nigeria.
- iii. To determine the impact of the number of Board meetings on Earnings Quality in Conglomerate Firms in Nigeria.

## **1.5 Hypotheses of the Study**

Based on the objectives of the study, the following hypotheses are formulated in null form:

**H<sub>01</sub>:** Board Size has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria.

**H<sub>02</sub>:** Proportion of Nonexecutive Directors has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria.

**H<sub>03</sub>:** The number of Board meetings has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria.

## **1.6 Scope of the Study**

This study focuses on board supervision particularly, using some attributes of corporate governance structures, within the context of listed conglomerate firms in Nigeria, There are six listed conglomerate firms in the Nigeria Stock Exchange (NSE) as at 31<sup>st</sup> December,2012 (NSE, 2012). The six listed firms constitute the population of the study. All the six firms were selected in the sample. The study covers a period of eight years, from 2006-2013. This period is selected for the fact that financial reports for these periods from the firms under study are available and to ensure that the work is up to date in coverage. Also, the firms disclose all the observations the research required for computing discretionary accruals using modified Jones (1991) model.

This traditional linear discretionary accrual model introduced by Jones (1991) is broadly adopted in accounting literature (Dechow, Sloan, & Sweeney, 1995; DeFond & Jiambalvo, 1994; Francis et al., 2005; and recently Smit, 2015). The model introduced by Dechow and Dichev (2002) is primarily used to estimate accruals from working capital, and indicates that accruals of working capital are related to cash flows from operating activities. The model first involves a regression method for estimating the relationship between working capital accruals and cash flows from operating activities. Explanatory variables include the current period, the previous period, and cash flows from future operating activities. To

exclude firm size and annual effects factors, relevant variables are divided by total assets in the present period to determine the proportion of working capital and operating cash

## **1,7 Significance of the Study**

Studies have been conducted on earnings quality and board supervision at different time and in different countries, most of the studies are well documented in accounting and finance literature. To the best of our knowledge no such studies have been carried out on impact of board supervision on earnings quality of listed conglomerate firms in Nigeria. Hence, studying the impact of board supervision on these firms in Nigeria would be of great significance, not in discouraging earnings management only but, the findings will add value to the existing literatures on board supervision and earnings quality and will serve as a reference for further research. The following benefits are expected from the findings of the study.

The outcome of this research will assist the shareholders of the listed conglomerate firms in Nigeria to know whether or not board supervision has impact on the quality of earnings of their investments in such firms and as a guide in taking relevant decision. The regulatory authority (SEC) will benefit from the outcome of the study. It will enable them examine the effectiveness of their supervision instruments as well as review and upgrade them where appropriate.

The findings can be useful to other stakeholders like government, employees and creditors in view of the fact that they have implications on all of them. The findings of the study will also contribute to the existing empirical studies on board supervision and earnings quality in Nigeria. The outcome of the study will also be useful and will serve as an input or motivation to further research on board supervision and earnings quality on firms in Nigeria.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

Several studies have been conducted on earnings quality, board of directors, board monitoring and corporate governance. These have, at least in part, been motivated by economic crisis and business failures that occurred the world over. This chapter critically reviewed previous studies on earnings quality, board supervision, board size and earnings quality and theoretical framework underpinning the study.

#### **2.2 Concept of Earnings Quality**

Accounting researchers continue to use the descriptor 'quality' in reference to the decision-usefulness of earnings in equity market valuation, but use of the term has been extended to other contexts as well, largely because of conversational understanding of the term quality as an indicator of superiority or excellence (Dechow, Ge, & Schrand, 2009). The earnings quality is considered to be important to users of financial information as well as to practitioners, regulators and accounting researchers since earnings is widely believed to be premier information item provided in financial statements (Lev, 1989).

Earnings quality has been discussed widely and there seems no agreement about its definition and measurement (Revsine, Collins & Johnson 1999; Penman & Zhang, 2002) thus, making it an elusive concept (Siegel, 1982). Earnings quality is used in numerous empirical studies to show trends over time; to evaluate changes in financial accounting standards and in other institutions (such as enforcement and corporate governance) to compare financial reporting systems in different countries; and to study the effect of earnings quality on the cost of capital.

Surprisingly, the concept of earnings quality is quite vague, despite several attempts to make it more precise and to provide a theoretical foundation. For example, Schipper & Vicent (2003) view earnings quality as the extent to which reported earnings faithfully represent Hicksian income. Hicks (1939) defines “Hicksian income as the amount that can be consumed (that is, paid out as dividends) during a period, while leaving the firm equally well off at the beginning and the end of the period”. With this concept, high earnings quality occurs when accounting earnings are closer to Hicksian income.

Standard setters such as the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) formulate in their draft on the first part of a common conceptual framework the need for high-quality financial reporting (IASB, 2008). They avoid defining quality, but list a number of

qualitative characteristics that should achieve a high quality, viz relevance, faithful representation, comparability, verifiability, timeliness, and understandability.

According to Schipper & Vincent (2003), the importance of earnings quality can be explained into three perspectives; namely investment perspective, financial information user perspective, and accounting standard setting perspective. From investment perspective, earnings quality provides a signal for resource allocation. Low quality of earnings is undesirable and inefficient because they reduce economic growth by causing capital to be misallocated. From a financial information user perspective, earnings are normally used in compensation arrangements and in debt agreements. Overstated earnings which are used as an indicator of managers' performance will result in overcompensation to managers. In addition, overstated earnings might mask deteriorating solvency, leading lenders mistakenly to continue lending. Accounting standard setters seek feedback on whether the accounting standards are effective and they tend to focus on outputs, including reporting earnings.

As stated by Barragato & Markelevich (2008), Earnings quality is of interest to users of financial statements because earnings, and the varied metrics derived there from, are utilized in making contracting and investment decisions. From a contracting perspective, low-quality earnings may result in unintended wealth

transfers. From an investor's vantage point, low-quality earnings are undesirable because they result in a defective resource allocation signal (Schipper & Vincent, 2003). This is also supported by Myers, Myers & Omer (2003), who state that poor quality of earnings is problematic because it can mislead investors, resulting in misallocation of resources.

Regarding the emphasis by those who design financial accounting standards about its usefulness, it is believed that financial reporting quality on the whole is considered more by those who use them for exchange and decision-making goals. Additionally, standard determiners considered earnings quality indirectly as a criterion for assessing the quality of financial reporting standards (Rahimian & Jaafari, 2006).

Earnings quality also refers to the stability, persistence, and lack of variability in reported earnings (Okolie, 2006). The earnings number acts as a summary measure of a firm's performance. Thus it is crucial that the earnings number reported in a firm's financial statements is reliable, relevant and free from manipulation (Barragato & Markelevich 2008).

Revsine, Collins & Johnson (1999) considered a profit to be more qualified when it is more consistent. Richardson, Sloan, Soliman & Tuna, (2001) introduced earnings quality as the consistency degree of profit gain in future periods. Benish

& Vargus (2002) considered earnings quality as consistency probability of current profit gain in the future. Penman & Zhang (2002) identified earnings quality as the ability to show future profits. Hodge (2003) viewed earnings quality as the difference degree of the reported net profit of the real profit. Michael *et al.* (2003) as reported in Okolie (2006) considered earnings quality as a degree of relationship between firm's previous profits and its future cash flow. White (2003) stated that earnings quality is the amount of conservatism employed in the reported profit. Scholer (2004) described earnings quality in a form of a relationship between promissory items and cash flows. All these views appeared complementing.

In Siegel (1991) five elements, such as the degree to which the economic reality of the firm is reflected, are mentioned as characteristics that raise the quality of profits, and eleven other items, including estimated discretion, are mentioned as characteristics which lower quality. Francis, LaFond, Olsson & Schipper. (2004) argued that there are seven attributes of earnings. These are accruals quality, persistence, predictability, smoothness, value relevance, timeliness, and conservatism. They examined their relationship with the cost of equity capital. Kothari (2001) mentions corporate evaluation by investors, and discretionary management as relevant factors, and categorises arguments on earnings quality. Schipper & Vincent (2003) present the value relevance viewpoint, and an

economics-based concept of income, examining attributes which specify earnings quality, such as time series properties of earnings, including persistence, predictive ability and variability, the qualitative characteristics of a conceptual framework, the relationships between income, cash, and accruals, and the implementation of decisions.

Earnings quality refers to the ability of the current earnings to forecast future earnings (Penman 2001). Earnings are of good quality if no earnings reversals are forecasted. With valuation in mind, the investors are interested in future earnings, that is, they buy future earnings using the current ones. Future earnings are said to be of poor quality if the current reported earnings are not good indicators of future ones. Schipper & Vincent (2003) assert that earnings are the summary indicator of the economic and institutional forces operating on the financial reporting process.

Dechow & Schrand (2004) provide two definitions, though tend to be similar. Firstly, a high-quality earnings number is one that accurately reflects the company's current operating performance, is a good indicator of future operating performance, and is a useful summary measure for assessing firm value. Secondly, earnings quality refers to a situation when the earnings number accurately annuitizes the intrinsic value of the firm. These definitions by Dechow & Schrand, indicated the absence of impairment of earnings figure. Pratt as reported in Hedge

(2003) considers quality of earnings to be the extent to which net reported income on the income statement do not differs from true earnings.

Penman (2002) stated that earnings quality is an important feature of financial reporting since investors buy future earnings. Despite the importance of earnings for stakeholders, the term earnings quality is also vague and has different interpretations. Some authors relate earnings quality to the accurate representation of underlying economic transactions and events. Another interpretation focuses on persistence of earnings, where earnings of higher quality are sustainable and persist into the future. A more general interpretation of the persistence idea is suggested by tying earnings quality with predictability, claiming that earnings of higher quality are a good indicator of future earnings.

Cohen (2003) defines earnings quality as the degree to which accounting figures more accurately represent the underlying economic fundamentals of the firm and the extent to which they map into operating cash flow realizations. Schipper & Vicent (2003) view earnings quality as the extent to which maximum amount that can be consumed is consistent with the maintenance of wealth. Chan , Chan , Jegadeesh, & Lakinishok (2004) consider earnings quality as the degree to which reported income reflects operating fundamentals. In Yee (2006), it is viewed that earnings quality has two guises, first as a fundamental attribute and second as

a financial reporting attribute. Fundamental earnings are the accounting profitability measure that gauges a firm's ability to make future dividend payments. As a financial reporting attribute, reported earnings are the imperfect signal of the fundamental earnings a firm announces. Earnings quality thus refers to how quickly and precisely reported earnings reveal fundamental earnings. Kirschenheiter & Melumad (2004) pointed out that high quality earnings are more informative and closer to the long run value of the firm. Revsine, Collins, & Johnson, (1999) consider that earnings are of higher quality when they are sustainable. Accordingly, Dechow, Ge & Schrand (2010) are of the view that higher quality earnings are more useful for decision-makers because they provide further information of a company's financial performance. Accordingly, Dechow, Ge & Schrand (2010) further stated that higher quality earnings are more useful for decision-makers because they provide further information of a company's financial performance.

Finally, in all the definitions stated above, quality of earnings could be seen in two ways; firstly, reported earnings would be of quality if it reflects the underlying economic performance of a firm in that particular period. Secondly, earnings quality portrays how well accounting earnings convey information about the phenomenon. We can for the purpose of this study adopt the definition of

Earnings Quality given by Cohen (2003) as the degree to which accounting figures more accurately represent the underlying economic fundamentals of the firm and the extent to which they map into operating cash flow realizations.

### **2.3 Concept of Board Supervision**

Supervision and management are actually two different things. Supervision is the direction of people at work and management is the planning and control of the work process (McNamara,2011). A person can be a supervisor (direct people at work) without being a manager and a person can be a manager (planning and control of work) without supervising anyone. In most workplace situations many supervisors also do some management and most managers also do some supervision. It is important to realize that supervision and management are two distinct and different activities requiring two very different skill sets.

According to Ogunsaju, (1983) Supervision is a way of stimulating, guiding, improving, refreshing and encouraging and overseeing certain group with the hope of seeking their cooperation in order for the supervisors to be successful in their task of supervision. The premise of agency theory is that boards are needed to monitor and control the actions of directors due to their opportunistic behaviour

(Berle & Means, 1932; Williamson, 1985 and Jensen & Meckling, 1976). Mangel & Singh (1993) believe that outside directors have more opportunity for control and face a more complex web of incentives, stemming directly from their responsibilities as directors and augmented by their equity position. In other words, non-executive directors are seen as the check and balance mechanism in enhancing boards' effectiveness. Others who also see the role of non-executive directors as monitors/controllers of management's performance and actions include Fama & Jensen (1983), Brickley & James (1987), Weisbach (1988), Pearce & Zahra (1992), Byrd & Hickman (1992), Salmon (1993), Pettigrew & McNulty (1995) and Mak (1996).

Board size may influence the level of voluntary disclosure. The level of disclosure is a strategic decision made of the board of directors. As a top-level management body, the board of directors formulates policies and strategies to be followed by managers. Boards of directors supervise and monitor the operation of the companies, and approve important management decisions. In order to achieve these, the board will require manpower. Rahman & Ali (2006) argued that large boards with varied expertise could increase the synergetic monitoring of the board in reducing the incidence of earnings management. However, when the committee

is too large, performance declines because of process losses and diffusion of responsibilities (Vafeas, 2005).

As expressed by Adepoju, (1998) the term supervision is derived from the word “Super video” meaning to oversee. It is an interaction between at least two persons for the improvement of an activity. It is also a combination or integration of processes, procedures and conditions that are consciously designed to advance the work effectiveness of individuals and group.

It could also mean assessing the effectiveness of one's control environment and taking the necessary action for correcting and remediating weaknesses or deficiencies found. Supervision is not a static, one-time event, but a constant effort by all in assessing and improving upon one's system of internal controls within any organization. According to Goergen (2012) internal corporate governance controls monitor activities and then take corrective action to accomplish organisational goals. Examples include: Monitoring by the board of directors, Internal control procedures and internal auditors, Monitoring by large shareholders and/or monitoring by banks and other large creditors: Given their large investment in the firm, these stakeholders have the incentives, combined with the right degree of control and power, to monitor the management.

Among the important internal corporate governance mechanisms emphasized by previous researchers are board composition (O'Sullivan, 2000; Beasley & Petroni, 2001; Salleh, Stewart & Manson, 2006 and Yatim, Kent, & Clarkson, 2006), ownership by directors and outside investors, ownership by financial institutional and non-institutional (O'Sullivan, 2000; Kane and Velury, 2002; Mitra, Hossain, & Deis, 2007), and CEO/Chairman (O'Sullivan, 2000; Salleh *et. al.*, 2006).

Board Supervision is essentially the practice of monitoring the performance of Management team, noting the merit and demerits and using befitting and amicable techniques to ameliorate the flaws while still improving on the merits thereby increasing the standard of financial reporting qualities and achieving organizational goals (Onasanya). Enamiroro, (2001) in his study on Determinants of effective and ineffective supervision in schools: Teachers perspectives stated that Supervision involves the process of checking, the positive implementation of curriculum assisting those implementing the curriculum. It is an inspective and supervisory action aimed at achieving organizational goals. The inspection aspect deals with fact finding and the assistance aspect is concerned with the establishment of a positive superior and subordinate relationship, with special emphasis on specialization directed towards utilization of available human and

materials resources in achieving organisational goals (Oghuvbu, 1998). Board of directors play a prominent role in checking records, ensuring that the policies of an organisation is strictly adhered to and making sure that the set objectives of the organization is achieved. Board of directors is superior to CEO and therefore exercises this by monitoring and supervising their functions in achieving the set target.

Supervisors typically are responsible for their direct reports' progress and productivity in the organization. Supervision often includes conducting basic management skills (decision making, problem solving, planning, delegation and meeting management), organizing teams, noticing the need for and designing new job roles in the group, hiring new employees, training new employees, employee performance management (setting goals, observing and giving feedback, addressing performance issues, firing employees, etc.) and ensuring conformance to personnel policies and other internal regulations.

Mbiti (1974) cited in Nwagwu, Ijeoma & Nwagwu (2004) views supervision as one of the basic requirements of administration that concerns itself with the tactics of efficiency and effective management of human and material resources. It is a way to advise, guide, refresh, encourage, simulate, improve and oversee an organisation with the hope of seeking the staff cooperation in order that they may

be successful in the task assigned. Task assigned to the board is enormous and significant and obvious result is expected. Anything short of the expectation cast doubt on the supervisory role of the board.

An institution's Supervisory Board is ultimately responsible for the conduct of the institution's affairs. The Supervisory Board controls the institution's direction and, hence, its overall policy. By doing this, the Supervisory Board determines how the institution will conduct its business on the long term. In general, the Supervisory Board establishes or approves and monitors the policies by which Management will operate.

The Supervisory Board also makes sure that adequate systems and controls are in place to identify and address problems before they become a threat. In adverse times an active and involved Supervisory Board can help an institution survive by taking the necessary corrective actions and, when needed, keep the institution on track until effective management can be re-established (Hesiang, 2010).

According to Chiang (2011) the independent director's competence is closely related to the effectiveness of a board of directors' supervision. Previous studies of the correlation between the term of audit committee members and effective supervision, as quoted in Chiang (2011), have reached inconsistent

conclusions. Most of these studies concluded that effective board supervision create no room for low quality reporting.

Also, some studies in the view of Vafeas, (2005) contended that long-term independent directors are more likely to become too friendly with the management and compromise their independence, thereby harming their ability to supervise and suggested that the Supervisory Board should periodically evaluate its own effectiveness and take appropriate steps to improve its performance.

For the purpose of this study, Board supervision is a process whereby the effectiveness of management team is checked by applying corporate governance control mechanisms in ensuring that the financial statements prepared is rich in terms of information contained, reliable and undiluted to enable users make beneficial judgment. It is used synonymously with monitoring in this work.

#### **2.4 Board Size and Earnings Quality**

The survival of an organisation is dependent upon how it deals with sources of uncertainty or dependency. Therefore, having directors who are able to reduce uncertainties is important. Each director has a unique set of human and social capital assets such as education, expertise, skills, access, and an individualised set

of contacts. According to resource-based theory, these unique bundles of assets and capabilities serve firms in different ways (Ameer, Ramli & Zakaria, 2009).

As a result of a renewed emphasis in Nigeria for effective corporate governance in the public, in June 2000, the Securities and Exchange Commission (SEC) of Nigeria set up the Committee on Corporate Governance of Public Companies in Nigeria to recommend a Code of Best Practices for Public Companies SEC (2003). The committee recommends the structure and composition of the board of directors and also recommends that the Board of Directors shall be composed of executive and non-executive directors under the leadership of a Chairman. The Board Size shall be between five and 15 persons in total. (Ogbechie, Koufopoulos & Argyropoulou, 2009)

In the U.S. and many developed countries, shareholders are represented by a board of directors in monitoring and controlling firm management. The role of this corporate governance mechanism is to mitigate the agency problems that arise from the separation of ownership and management (Sloan, 2001; Hermalin & Weisbach, 2003). Fama & Jensen (1983) suggested that the board performs both a management decision role and a decision control role. The former entails ensuring the efficient identification and selection of investment projects, thus directly affecting firm performance. The control role aims to restrain managers' latitude to

derive excessive personal benefits at the expense of the firm, and indirectly affects firm performance via preserving the integrity of assets and external reporting.

A primary role of the board of directors is to monitor management on behalf of shareholders to obtain specific information that it can use to hire, fire, and set the compensation of top management (Fama & Jensen 1983). As fiduciaries of shareholders, boards are charged with making decisions in an informed manner and exercising reasonable diligence in gathering and considering all material information. Indeed, recent theoretical models of board of-director monitoring highlight the importance of information acquisition and its relation with board activity and board structure (Hermalin & Weisbach, 1998; Raheja, 2005; Adams & Ferreira, 2007; Harris & Raviv, 2008).

Board size has been shown to be a significant part of the ability of boards to effectively monitor management and to work efficiently together to oversee the running of the business (Obeua, 2009). Board size is an indicator of both its monitoring and advisory roles, both of which may contribute to its insight into management behavior (e.g., Anderson, Mansi & Reeb, 2004 and Coles, Daniel & Naveen, 2008).

According to Petra, (2007) one characteristic that is claimed to have an impact on the effectiveness of the monitoring function is the number of members

on the board. Existing studies of the relation between board size and earnings quality have shown mixed results. A larger board is viewed as having greater ability to safeguard shareholders' interest as it has more capabilities (Zahra & Pearce, 1989), a broader range of experience (Xie, Davidson & Daulton, 2003), and varied expertise (Rahman & Ali, 2006), all of which could increase the synergistic governance of the board. However, the drawback is that larger boards may be slower in making decisions and more likely to oppose innovation.

Yermack (1996) showed that companies with smaller boards have higher market valuations. In the U.S.A. similar result is reported by Vafeas (2000), who suggested that the reported earnings of firms with the smaller boards (five members on the board) are viewed as more informative by the market. These studies supported the theory that timely decision-making and better communication of smaller boards outweighs the higher effectiveness of large boards in controlling and monitoring. On the other hand, several studies have documented conflicting evidence. Larger boards are associated with (i) lower underpricing for firms undertaking an initial public offering (Certo, Daily & Dalton, 2001), (ii) better updates of management earnings forecasts (Karamanou & Vafeas, 2005), and (iii) lower variability of corporate performance (Cheng, 2008). In short, these studies suggest that firms with larger boards have higher quality in their financial

reporting. The Nigerian Securities and Exchange Commission (SEC) Corporate Governance Guide (2003) stated that however, the size of the board should not exceed 15 persons or be less than five persons in total. Thus, the minimum size and maximum size is stated expressly. This provision is in line with international best practices.

Mashayekhi & Bazaz (2008) investigated the role of corporate governance indices, such as board size, board independence, and board leadership on the performance of firms on the Tehran Stock Exchange (TSE) for the period of 2005-2006. They noted that independent directors have a positive effect on firm performance, while the board size is negatively associated with it. In addition, the research by Mashayekhi & Esmaili (2006), on 135 firms on the TSE during the period of 2002-2004 before the implementation of the Iranian Code of Corporate Governance, concluded that there was no significant correlation between board independence and earnings quality, since non-executive directors did not have an effective controlling and monitoring role in the companies. They explained that non-executive directors do not have enough information about critical issues and are not acquainted with the problems affecting the company, thereby hindering efficient and effective control by them. The findings of the study support the contention that smaller boards are likely to be more efficient in monitoring

management (Yermack, 1996; Eisenberg, Sundgren, & Wells, 1998; Fuerst & Kang, 2000; Loderer & Peyer, 2002). This result contradicts that of Dalton et al. (1998) who find a positive and significant relationship between board size and financial performance. Their study confirms a positive relationship between outside (independent) directors and firm performance, which is contrary to that of Yermack (1996) and Klein (1998) who find that a high percentage of outside directors has a negative effect on firm performance.

Jiang, Lee, & Anandarajan, (2008) studied the association between corporate governance and earnings quality. Their results suggest that only firms in the highest category of corporate governance experience significantly improved quality of earnings. They document that corporate governance is negatively associated with small earnings surprises. Their findings imply that firms with weak corporate governance are more likely to manage earnings in order to meet or beat analyst forecasts.

## **2.5 Review of Empirical Literature on Earnings Quality**

A board is generally composed of inside and outside members. Inside members are selected from among the executive officers of a firm. They either belong to the management group or are the family that owns the firm. Outside directors are members whose only affiliation with the firm is their directorship.

Empirical evidence on the importance of nonexecutive directors on board has been mixed. Baysinger & Butler, (1985) as reported in Ogbechie, Koufopoulos & Argyropoulou (2009) observed that the outside directors are more effective than inside directors in maximizing shareholders' wealth. In contrast, the inside directors can contribute more to a firm than outside directors due to their firm's specific knowledge and expertise.

Public firm is required to implement good corporate governance as assurance to reduce information asymmetry between firm and its stockholders. Corporate governance mechanism should be able to limit any improper actions of the firm's management. Base on this, Tatang & Widi (2011) investigated whether the duality role of the board affects earnings management practice of firms making initial public offering at Indonesian Stock Exchange. The study also examines other corporate governance mechanism factors, namely the number of board of commissioners (Board of Directors), the proportion of independent board of commissioners, size of firm, financial leverage, and profitability. Earnings management was measured using Cross-Sectional Modified Jones model. The study employs a total of 60 firms that went public from 2000 to 2006. The result shows that duality status of board of commissioners positively and significantly affects earnings management in Initial Public Offering (IPO) firms. This could be

interpreted that board of directors with duality role had a lower function in monitoring the firms' performance so that management have opportunity to manage reported earnings. When board of commissioners have dual role, the level of earnings management is getting intense, and vice versa. Size of board of commissioners and profitability are positively related to earnings management. This contradicts with the prior expectation that the more the Board of Commissioners (BOC's) members the lower the level of earnings management as the monitoring power increases (Dalton et al., 1999; Bradbury et al., 2006). This finding should be treated with caution. It seems that the presence of BoC is not effective in preventing management from conducting any action which affects earnings management. The question raised in relation to the finding reported here is that there is no guarantee that larger size of BoC could be effective in monitoring the management of firm.

Patelli & Prencipe (2007), studied *The Relationship between Voluntary Disclosure and Independent Directors in the Presence of a Dominant Shareholder*. The study carried out the empirical analysis on 175 non-financial Italian listed companies, all controlled by a dominant shareholder. Voluntary disclosure is measured through three alternative disclosure indexes. Independent directors are identified not only according to a formal/legal definition, but also through stricter

criteria. The empirical test was based on a multivariate analysis controlling for size, residual ownership diffusion, leverage, profitability and labour pressure. The finding was that composition of the board is one of several factors that can mitigate agency conflicts within the firm.

Abdur Rouf (2010) examined corporate governance factors and their influence on voluntary disclosure. These factors include Proportion of independent nonexecutive directors on the board, board leadership structure, board size, board audit committee, firm's size, Percentage of equity owned by the insiders to all equity of the firm and Profitability of the firm. The study aimed to determine which of these factors were significantly related to increased disclosure. The study used the disclosure index to measure voluntary disclosure on a sample of 120 listed non financial companies in Dhaka Stock Exchanges (DSE) 2008. The study used ordinary least squares regression model to examine the relationship between explanatory variables and voluntary disclosure. The result of the study shows that the extent of voluntary disclosure is positively related for firms with a dual leadership structure. The findings of the research supported it more that higher number of directors on a board lead to higher voluntary disclosure and the level of voluntary disclosure is associated positively for firms that have an audit committee. This result is similar to that of Barako, et al.,( 2006); Eng & Mak,

(2003) Ho & Wong,( 2001); Simon & Kar, (2001); Ros & Terry, (2000); Forker, (1992); who reported a negative association between the board composition variable and the extent of voluntary disclosure.

Chen & Jaggi (2000) examined whether comprehensive financial disclosures, used as a proxy for corporate board's responsiveness, are positively associated with the proportion of non-executive directors on corporate boards, and whether family control of the firm has an impact on this association. The findings suggested that the ratio of non-executive directors to the total number of directors on corporate boards is positively associated with the comprehensiveness of financial disclosures, and this association appears to be weaker for family controlled firms compared to non-family controlled firms. These findings are consistent with agency theory tenets where a higher proportion of independent directors enhance voluntary financial reporting (Barako, Hancock, & Izan, 2006). The reason for this is that the presence of independent directors reduces the cost of voluntary disclosure because directors are generally independent of the day to day business operations of the firm (Patelli & Prencipe, 2007).

Evidence from research conducted by Haniffa & Cooke (2002) on corporate accounting indicates that the interaction of environmental factors influences disclosure practices. The purpose of their study was to examine the importance of

various corporate governance and cultural (race and education) characteristics, in addition to firm-specific factors, as possible determinants of voluntary (non-mandatory accounting and non-accounting information) disclosures in the annual reports of Malaysian listed corporations. The results of the regression analysis indicated significant associations (at the 5 percent level) between two corporate governance variables (viz. chair who is a non-executive director and domination of family members on boards) and the extent of voluntary disclosure. Support for these assertions is further provided by Pettigrew & McNulty (1995); Simon & Kar (2001); Eng & Mak (2003); Barako, *et al.*(2006). Ho & Wong (2001) did not find association between the proportion of nonexecutive directors and the extent of voluntary disclosure. Aktaruddin, Hossain, Hossain & Lee, (2009); and Obeua, (2009) found that firms can expect more voluntary disclosure with the inclusion of a larger number of nonexecutive directors on the board. A firm may have higher level of disclosure if the boards consist of more nonexecutive directors. This finding has implications for corporate governance policy formulation by the Malaysian Institute of Corporate Governance (MISG). One cultural factor (proportion of Malay directors on the board) is significantly associated (at the 5 percent level) with the extent of voluntary disclosure suggesting that governmental focus on culture may solicit a response to secrecy from those who feel threatened.

Abdoli & Royae (2011) in their study examined the effect of board independence on earnings quality of the companies listed in the Tehran stock exchange (TSE). It makes use of the collected data from 165 companies quoted in the TSE during a period from 2005 to 2010. Regression and forward statistical method was applied to conduct the study. The findings indicate that earnings quality increases in the companies with higher proportion of non-executive directors. Also, the significance of the relationship between executive directors and earnings quality is lower than the relationship between non-executive directors and the reported earnings quality. Furthermore, the impact of firm size on the increase of earnings quality is confirmed, being positive and significant. The relationship between the leverage ratio and earnings quality is confirmed, being negative and significant though. Moreover, earnings quality is higher in privately owned companies compared with publicly owned companies.

In a related study carried out by Fodio, Ibikunle, & Oba (2013), on the effect of corporate governance mechanisms on reported earnings quality of listed Insurance companies in Nigeria. Using twenty five (25) quoted insurance firms during the period 2007-2010, the study regressed five governance mechanisms on reported earnings quality proxy. Multiple regressions were employed for the analysis using the software SPSS version 17.0. Their findings revealed that board

size, board independence and audit committee size are negatively and significantly associated with earnings management while audit committee independence and independent external audit have positive relationship with discretionary accruals.

Board size has been shown to be a significant part of the ability of boards to effectively monitor management and to work efficiently together to oversee the running of the business (Persons, 2006). Board size is an indicator of both its monitoring and advisory roles, both of which may contribute to its insight into management behavior (e.g., Anderson, Mansi, & Reeb, 2004; Coles, Daniel, & Naveen, 2008). Larger boards are likely to provide more expertise and diversity and to increase the board's monitoring capacity (Dalton, Daily, Ellstrand, & Johnson, 1998; Pearce & Zahra, 1992 and John & Senbet, 1998). Additionally, larger boards are more likely to include more independent directors with valuable experience and, hence, they are able to delegate more responsibilities to board committees than smaller boards; this also can prevent or limit managerial opportunistic behaviour (Xie, Davidson, & DaDalt, 2003).

Board size may influence the level of voluntary disclosure. The level of disclosure is a strategic decision made by the board of directors. As a top level management body, the board of directors formulates policies and strategies to be followed by managers. It has been argued that a greater number of directors on the

board may reduce the likelihood of information asymmetry (Chen & Jaggi, 2000). Research emphasizes the importance of strategic information and resources in a highly uncertain environment. As reported in the work of Abdur-Raouf, (2010) the size of the board is believed to affect the ability of the board to monitor and evaluate management and small board encourages faster information processing (Zahra, Neubaum, & Huse, 2000). Aktaruddin, Hossain & Lee, (2000) found a positive association between board size and level of corporate voluntary disclosure. Further, the ability of directors to control and promote value creating activities is more likely to increase with the increase of directors on the board. With more directors, the collective experience and expertise of the board will increase, and therefore, the need for information disclosure will be higher. These views tend to go opposite directions.

The corporate governance literature often refers to ‘the percentage of non-executive directors’ as the composition of the board (Yakasai, 2001). As the board is viewed as a monitoring mechanism to safeguard shareholders’ interests, a higher proportion of non-executive directors are preferable. This is consistent with the agency theory premise about the separation between shareholders and managers in a company that needs to be controlled and monitored. Non-executive directors are preferable as they could increase the effectiveness of the board monitoring function

(Gupta & Fields, 2009; Jaggi, Leung, & Gul, 2009) and ensure high quality of reported earnings.

Lee, (2013), investigated companies publicly listed in Taiwan from 2002 to 2010 to examine whether independent directors improved the quality of earnings and analyzed whether the control rights of a controlling shareholder mitigate the impact of independent directors on earnings quality. Empirical results from this study showed that independent directors can improve the quality of earnings, and those hired because of mandatory appointments had a greater positive effect on earnings quality compared to directors who were voluntarily hired. In addition, they also found that the controlling share held by a controlling shareholder reduces the benefit of independent directors on earnings quality, supporting the notion that establishing independent directors can reduce the volatility of abnormal accruals, affirming the effectiveness of the system of independent directors for raising earnings quality.

In terms of the level of disclosure, Alsaeed (2006) argued that higher debt firms have higher agency costs and therefore need to have more information disclosed in order to satisfy the needs of creditors for information. A study by Craig & Diga (1998) have found a significant positive relationship between debt ratio and level of disclosure, while Alsaeed (2006) had failed to find it significant,

whereby it was argued that this was probably due to the fact that the creditors may have shared private information with their debtors. In contrast, higher leverage company is argued to have higher bankruptcy risk, which in turn will lead to litigation risk (Rahman & Ali, 2006) and thus, increase management's tendency to manipulate firm's financial reporting to overcome this risk. This has been supported by findings by Klein (2002) which showed that a company's leverage is significantly positively related to the level of abnormal accruals. Moreover, a study by Davidson, Stewart and Kent (2005) had also found a significant positive relationship between leverage and discretionary accruals. However, a subsequent study by Rahman and Ali (2006) and Yang & Krishnan (2005) did not document any significant relationship between company leverage and accruals.

Hassan & Bello (2013) attempted to investigate firms' characteristics from perspective of structure, monitoring and performance elements and the quality of financial reporting measured by modified model of Dechow & Dechev (2002) of listed manufacturing firms in Nigeria. The study adopted Quasi experimental research design with pooled balanced panel data of 24 firms served as sample of the study using multiple regression as a tool of analysis. The result obtained thereof revealed that larger and more leveraged firms in Nigerian manufacturing sector are less likely to manage earnings and increase in sales and that institutional

investors served as a monitoring tool of preventing managers from opportunistic behavior in managing earnings. Further analysis revealed that, profitability and independent directors were positively associated with earnings quality while liquidity is inversely related with quality of financial reporting despite significant at 1% level of significance, concluding that firm characteristics of listed manufacturing firms in Nigeria have impacted significantly on their financial reporting quality.

As reported in the work of Sanda, Mikailu & Garba (2010), large creditors, like large stakeholders, also have interest in seeing that managers take performance-improving measures. Referring to the works of Kaplan and Minton (1994); Kang & Shivdasani (1995) and Shleifer & Vishny (1997) supported this view. John & Senbet (1998) postulated that, debt holders are entitled to claims and these have the tendency to rise at low levels of firm performance, and to remain constant beyond a certain level of that performance. Thus, good performance benefits the stockholders more than it does debt holders, but this is not true when performance is very low. In fact as the firm moves towards bankruptcy, equity holders face the risk of losing only their shareholdings, passing the burden of such bankruptcy to the debt holders. Taken together, these outcomes encourage managers working to protect the interest of equity holders to embark upon risky,

high-return projects. In order to ensure the protection of the interest of creditors, the literature suggests that they be represented on the board of the firm.

Vafeas (1999) found that, as the number of board meetings increases, the operating performance of firms improves. This suggests that the frequency of meetings is an important aspect of an effective board. A board that meets frequently should be able to assign more time to issues such as financial reporting quality. According to clause 9 of the Iranian Code of Corporate Governance, board meetings should be held at least once per month. Whilst in Nigeria, to maintain effective control over the company and monitor the executive and management, the code of corporate governance (2003), provided that the board should meet at least once in a quarter with at least 75% of attendance by every member. It is expected that an increase in the number of board meetings will provide more effective monitoring and probably improve financial reporting and earnings quality in Nigerian firms.

## **2.6 Review of Studies on Board Supervision**

In current business structure, it is inevitable to separate ownership from management and lack of an effective supervisory mechanism on management in such corporations will increase probability of inefficient allocation of resources and expand organizational problems and usually this lead to issues such as non-

transparent and misleading reports to mask problems (Barzegar & Salehi, 2008). If the quality of reported accounting information is weak it is likely that receivers of these information would not made appropriate decisions (Salehi & Abedini, 2008).

According to the corporate governance Guidance notes for the supervisory board of supervised financial institutions (2011), a supervised financial institution, like any other corporate organization has shareholders and a Board of Supervisory Directors, elected by the shareholders, to oversee and supervise the management of the institution's resources and activities. The members of the Supervisory Board must exercise reasonable care and sound judgment in governing the affairs of the institution. Corporate scandals have occurred frequently across the world in the past decade, so virtually all industries have attached importance to strengthening corporate governance. Corporate governance refers to the supervision of companies by board directors and supervisors, the perfection of the shareholding structure, and the enhancement of information transparency (Chiang, 2011).

Ashbaugh, Collins, & LaFond (2006) has defined corporate governance as a set of processes that reduce representative risk through increasing the supervision on executive actions, restricting their speculative behavior and improving the quality of published information of firms. The financial crisis in America, Europe and Asia is clear for all countries that is why the subject of transparency and

accountability in corporate governance, in investors' confidence and the performance of national economy are important. Here, corporate governance and board supervision can be seen to have the same meaning.

Shehu (2013) examined monitoring characteristics and financial reporting quality of the Nigerian listed manufacturing firms. Financial reporting quality was represented with earnings management using the modified Dechow & Dichev's (2002) model. Using 32 firms-years longitudinal paneled of 160 observations, panel OLS was estimated and controlled for fixed/random effects. The result shows that the control variables both returns on assets and return on equity are significant. Leverage, independent directors, audit committee, institutional, block and managerial shareholdings are all significant implying monitoring characteristics is influencing financial reporting quality of quoted manufacturing firms in Nigeria.

Patrick & Markus (2011) in their paper, stated that in contrast to the one-tier system typically for Anglo-Saxon countries, the German Stock Corporation Act (GSCA) has provided two administrative bodies with the management board and the supervisory board. This two-tier system, according to them, follows the idea of an organizational separation of management and supervision. This principle of separation is represented in the fact that members of the supervisory board may not

simultaneously belong to the management board of the company. While the management board manages the firm under its own responsibility, the supervisory board appoints monitors and advises the members of the management board and is involved in decisions of fundamental importance to the enterprise. The members of the supervisory board are elected by the shareholders at the general meeting. In firms with more than 500 or respectively 2,000 employees within Germany, the employees are also represented in the supervisory board. Therefore, one-third of the supervisory board members in enterprises with more than 500 employees and one half of the members in companies with more than 2.000 employees are representatives elected by the employees. In firms with more than 2,000 employees, the chairman of the supervisory board has the casting vote in the case of split resolutions. In order to increase its efficiency, the supervisory board has the possibility of appointing committees. Empirical results show that several companies on the German prime standard comply with this recommendation (Werder & Talaulicar, 2010). This is in line with the role of board of directors in Nigeria Firms

Hesiang (2010) in his study on Board Supervision Capability and Information Transparency, considered the importance of directors' compensation in corporate governance. The results provide evidence to demonstrate that board

supervision capabilities may complement strong governance. Using both primary and archival data from Taiwan, found that compensation can encourage company board of directors to act in the best interests of shareholders when there is greater board independence. Their study also reveals that board supervision enhanced transparency and that offering rewards to independent manager's results in improvement of firms' performance, and training plays a decisive role in improvement of information transparency. Further, the results provide additional evidence to demonstrate that board supervision capabilities may complement strong governance.

Xia (2009) conducted research on the relationship between characteristics of supervisory board and earnings quality based on the empirical analysis of the annual report of China's 160 listed companies in 2006. The results indicated that there is no significant correlation between characteristics of supervisory board and earnings quality, as the independent supervisory organ in company's administration structure of their country, the board of supervisor has defects on system design and which has not played its due role in practice. They believe that, to some extent, it is the advantageous status of the management that has put supervisory board at a disadvantage.

Velury & Jenkins (2006) examined supervisory role of institutional investors in earnings quality and using a multivariate regression they measured the effect of variables ownership percentage of institutional investors, ownership percentage of managers, firm size, and debt ratio on earnings quality. Their findings indicated a positive and significant association between institutional owners and earnings quality and inverse effect of ownership concentration on earnings quality

Lijuan, Aly, & Robert (2014) in their work examined whether the independence, financial/accounting expertise and official background and a higher proportion of independent directors and supervisors are related to the absolute value of discretionary accruals or discretionary revenue. By conducting the research on a large sample of Chinese listed companies from 2005 to 2010, the empirical results suggested that Chinese two-tier board structure comprising a board of directors with at least one third independent directors and supervisory board fails to mitigate earnings management.

In a unitary board structure, a company's board of directors plays an administrative role and comprises executive and non-executive directors. In a two-tier board structure, a company's board of directors consists of the supervisory board and management board. Hu, Tam & Tan, (2010) stated that the two-tier board is a primary governance structure to safeguard the minority shareholders' for

review and approval. Though inspired by the German system, China does not simply copy it. The two boards are obliged to submit their reports to the shareholders' meeting.

Firth, Fung, & Rui, (2007) stated that supervisory boards help to improve the integrity of earnings. In the study conducted they stated that, there have been controversial arguments about the mandatory requirement of having both supervisory board and independent directors in China. They cite instance of some overlapping responsibilities such as supervising the company's financial affairs, which consequently, Xi (2006) believes will destroyed overall monitoring efficiency. Xiao, Dahya, & Lin, (2004) provide that when supervisors lacked accounting expertise, the secretary to the board of directors generally drafted the supervisory report for them. Wang & Liu (2006) compare the functions and rights of independent directors with supervisory directors in China and found that they complement each other.

Majdi, Liang & Qiang (2011) in their paper, examined whether Islamic banks are less likely to manage their earnings, and how the corporate governance system, especially Shari'ah Supervisory Boards (SSBs), impacts the earnings management behaviors within Islamic banks. Using a sample of Islamic Banks and a matched non-Islamic Banks in the ERF region, they found that; Islamic Banks

are less likely to conduct earnings management as measured by both earnings loss avoidance and abnormal loan loss provisions. And that, there is no significant difference between Islamic Banks with and without SSBs in terms of earnings management. Also, several SSB characteristics and board characteristics, such as SSB size, Auditing Organization for Islamic Financial Institutions (AAOIFI), and outside board members, are important determinants of the earnings management for Islamic Banks with SSBs.

Johari, Mohd, Jaffar, & Sabri, (2008) viewed that there is no unified definition about corporate governance nonetheless based on a general definition it could be defined as a discipline that corporations are guided and controlled by it. So, the place of board of director as a guidance foundation responsible for supervision and control on the executives work for maintaining ownership interests of shareholders would be important more than before. Performed researches in this area show that some of characteristics of board members including independence and competence are effective mechanism for supervision on management (Peasnell, Pope, & Young, 2006).

Onalo, Mohd & Ahmad (2013) stated clearly that, banks' ability to engender micro or global economic growth and development depends on the health, soundness and stability of the sector. In order to fulfill all those functions, the

banking sector needs to be trustworthy and transparent. Thus, proper functioning, through adequate supervision and governance of the financial sector-banking, hinges on adequate transparency and accountability being built into reporting practices in the corresponding sub-sectors. In this regard, inadequate supervision of financial sector will have negative consequences on other sectors of the economy.

The majority of these literatures reviewed relied on data of listed companies from the places other than Nigeria. Despite the importance and empirical findings of these studies it is not clear whether these results can be generalised to other time periods and countries. Also, Many of these researchers are of the view that corporate failures were caused by inadequate corporate governance, which included lack of board oversight and poor strategic decisions. But non used board of directors internal monitoring mechanisms (such as board size, Proportion of non-executive directors and number of board meetings) on earnings quality of conglomerate firms, in Nigeria.

## **2.7 Theoretical Framework**

This study discusses theories related to the dependant variables and independent variables. They are to serve as basis for our study. These are Agency theory, Stewardship theory and Resource Dependency theory.

### **2.7.1 Agency Theory**

Agency theory is propounded by Jensen & Mecklings (1976). According to this theory, the conflict of interest between owners and managers give birth to the managers' opportunistic tendency such as earnings management. Also, opportunistic behavior includes shirking and indulging in excessive perquisites at the expense of shareholder interests (Williamson 1985). A major structural mechanism to curtail such managerial "opportunism" is the board of directors. This body provides a monitoring of managerial actions on behalf of shareholders (Ramsey & Blair, 1993).

Advocates of agency theory believe that board comprising majority of outside directors reduce agency conflicts as they provide effective monitoring tool to the board (Fama & Jensen, 1983). They argue that the inclusion of outside directors increases the boards' ability to be more efficient in monitoring the top management and to ensure there is no collusion with top managers to expropriate stockholder wealth as they have incentives to develop their reputations as experts in decision control. Normally, the outside directors are expert managers from other large organizations and with their expertise, independence, objectivity and legal power, outside directors become potentially powerful governance mechanisms to mitigate agency costs and protect shareholders wealth (Li, 1994).

The agency theory assumes that individuals have access to complete information and investors possess significant knowledge of whether or not governance activities conform to their preferences and the board has knowledge of investors' preferences (Smallman 2004). Therefore according to the view of the agency theorists, an efficient market is considered a solution to mitigate the agency problem, which includes an efficient market for corporate control, management labour and corporate information (Clarke 2004).

According to Johanson & Ostergen (2010) even though agency theory provides a valuable insights into corporate governance, its' applicability is to countries in the Anglo-Saxon model of governance as in Nigeria. The founders of agency theory argued that losses to the principal resulting from interest divergence may be curbed by imposing control structures on the agent. Agency theory made some assumptions about individualistic utility motivations resulting in principal-agency interest divergence which, may not hold for all managers. For this reason, additional theory may be needed to explain relationship on other noneconomic assumptions (Eisenhardt, 1989).

### **2.7.2 Stewardship Theory**

In an attempt to solve the problems in agency theory, stewardship theory has been introduced. According to Donalson & Davis (1989) the theory explains

relationship based upon other behavioral premises. Stewardship theory, defines situations in which managers are not motivated by individual goals but rather are stewards whose motives are aligned with objectives of their principals. Davis, Schoorman & Donaldson (1997) posit that, Stewardship theory has its roots in psychology and sociology and is designed for researchers to examine situations in which executives as stewards are only motivated to act in the best interests of their principals. In this theory, the model of man is based on a steward whose behavior is ordered such that pro-organizational, collectivistic behaviors have higher utility than individualistic, self serving behaviors.

Stewardship theory sees a strong relationship between managers and the success of the firm, and therefore the stewards protect and maximise shareholder wealth through firm performance. A steward, who improves performance successfully, satisfies most stakeholder groups in an organization, when these groups have interests that are well served by increasing organisational wealth (Davis, Schoorman & Donaldson 1997). When the position of the Chief Executive Officer (CEO) and Chairman is held by a single person, the fate of the organization and the power to determine strategy is the responsibility of a single person. Thus the focus of stewardship theory is on structures that facilitate and empower rather than monitor and control (Davis, Schoorman & Donaldson 1997). Therefore

stewardship theory takes a more relaxed view of the separation of the role of chairman and CEO, and supports appointment of single person for the position of chairman and CEO and a majority of specialist executive directors rather than non-executive directors (Clarke 2004).

### **2.7.3 Resource Dependency Theory**

The Resource Dependency Theory is the result of studies on Board composition by sociologists who have focused on the study of interlocking directorates and their implication on institutional and societal power (Pettigrew, 1992.) It has its origins in the open system theory as such organizations have varying degree of dependence on the external environment, particularly for the resources they require to operate. Uncertainty and dependence propel an organization to proactively manage the environment (Pfeffer & Salancki, 1978) and the effect this has on financial and customer outcomes when a contextual factor, high Firm power is taken into consideration. Corporate Board are viewed as means to manage external dependency (Pfeffer & Salancik, 1978), reduce environmental uncertainty (Pfeffer, 1972) and transaction costs associated with the environmental interdependency (Williamson, 1984).

Lawrence & Lorsch (1967) linked the resource dependency theory to corporate governance. They stated that successful organizations possess internal

structures that match environmental demand, which links to Pfeffer's (1972) argument that board size and composition is a rational organisational response to the conditions of the external environment. Furthermore, directors may serve to connect the external resources with the firm to overcome uncertainty (Hillman, Cannella & Paetzols 2000), because coping effectively with uncertainty is essential for the survival of the company.

The implication of this theory is that corporate Boards will reflect the environment of the Firm (Boyd, 1990; Hillman, et al, 2000; Pfeffer, 1972) and that corporate directors will be chosen to maximize the provision of important resources to the Firm. Each director may bring different linkages and resources to a Board. Board composition will thus theorize to reflect a matching of the dependencies facing an organization to the resources acquisition potential of its Board members (Hillman, et al, 2000). From the foregoing discussion, it can be seen clearly that unlike the Agency Theory, Resource Dependency Theory ignores alternative activities of the Board such as providing advice (Westphal, 1999; Lorsch & Maclver, 1989,) and strategizing (Kesner & Johnson, 1990). However, this theory supports the appointment of directors to multiple boards of their opportunities to gather information and network in various ways.

The resource dependency theory maintains that the Board is an essential link between the Firm and the external resources that a Firm needs to overcome uncertainty because coping effectively with uncertainty is essential for the survival of the company through board supervision. Therefore, the theory adopted for the purpose of this study is the resource dependency theory.

## **2.8 Summary**

The accounting literature embraces several definitions of earnings quality. Some relate to the persistence of earnings (time-series properties of earnings). What exactly are "high quality" earnings? According to Kirschenheiter & Melumad (2004) high quality earnings are earnings that are more informative and closer to the long run value of the firm. Earnings quality is also used in many empirical studies to examine changes in earnings characteristics over time, to assess the effects of changes in accounting standards and the institutional environment, to compare financial reporting across countries, and to measure market price and return effects of firms exhibiting different earnings quality.

The chapter reviewed previous studies on chosen determinants of earnings quality used in the study. The review concluded that there is no acceptable definition of earnings quality because of its varying interpretation and so it is still an issue undecided by various scholars. Also, theories as related to the study were

reviewed but the resource dependency theory is considered as the theory that underpins the study. The chapter covers review of past studies on concept of earnings Quality, Board Supervision and board size, which are the independent variables of the study.

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.1 Introduction**

This chapter discusses the methodology used for the study. It discusses the research design, population of the study, sample size and sampling technique, research instruments and techniques of data analysis.

#### **3.2 Research Design**

This research adopts correlation research design. A correlation research design was used for this study to establish the impact of board supervision on earnings quality of listed conglomerate firms in Nigeria since it allows for testing of pre-existing relationship between and among variables and the making of predictions regarding these relationships and researcher makes no attempt to manipulate an independent variable. While the hypotheses were tested using information obtained from the historical data documented in the Nigeria Stock Exchange (NSE) Fact Book, published annual reports and accounts of those firms under study. The variables of study were controlled because as noted in Johnson, Khurana & Reynolds,(2002), they can affect financial reporting quality in both ways, in terms of the level of sophistication of the financial reporting system and in

terms of management incentives to manipulate earnings. This correlation research design is therefore, most appropriate for this study because it allows for testing of expected relationships between and among variables and the making of predictions regarding these relationships (Shehu & Ahmad, 2013).

### **3.3 Population and Sample of the Study**

The population of the study comprises all the six Listed Conglomerates Firms operating in Nigeria as at 31<sup>st</sup> December, 2012. These listed conglomerate firms in Nigeria are companies which are quoted on Nigeria Stock Exchange for the purpose of trading on a regular basis by the investing public. All the six firms are studied so as to enable us have the complete nature of the firms for generalization purposes. The period of the study is seven years (2006 -2013) both years inclusive. This period is chosen for the study because the financial statements of these firms discloses all the observations the research required for computing discretionary accruals as at the periods

### **3.4 Sources and Method of Data Collection**

For the purpose of this study, the data were collected from secondary source. The method of data collection is archival and documentary method. The data were obtained specifically from the annual reports and accounts of the sampled

conglomerates firms obtained from the web site and NSE Facts Books covering the years of study. Archival method of data collection involves using previously compiled information to answer research questions. The researcher does not actually collect the original data, instead he or she analysis existing data such as statistics that are part of public records, financial reports, information containing data base (Donald & Theresa; 2010 and Paul, & Scott, 2012).

### **3.5 Techniques of Data Analysis**

In order to achieve the objectives and testing the formulated hypotheses of the study, multiple regressions were employed for data analysis. This is chosen as there are more than one variable for the study. Specifically, we collect the following variables: board size, proportion of non executive directors and numbers of meeting held by the board.

### **3.6 Model Specification:**

The model is specified on an empirical framework using the variables (board size, proportion of non executive directors, and numbers of meeting) for this study, to investigate the Impact of Board Supervision on Earnings' Quality of Nigerian Listed Conglomerates Firms. The study adopts the discretionary estimation model by Dechow & Dichev, (2002) as modified by Francis, LaFond, Olsson & Schipper,

(2005) which has recently been considered as a better proxy for earnings quality (Jaggi, Leung, & Gul, 2007). The residual of this will be used as a proxy of earnings quality:

$$\frac{\Delta TCA_{j,t}}{Assets_{j,t}} = \beta_{0,j} + \beta_{1,j} \frac{CFO_{j,t-1}}{Assets_{j,t}} + \beta_{2,j} \frac{CFO_{j,t}}{Assets_{j,t}} + \beta_{3,j} \frac{CFO_{j,t+1}}{Assets_{j,t}} + \beta_{4,j} \frac{\Delta REV_{j,t}}{Assets_{j,t}} + \beta_{5,j} \frac{PPE_{j,t}}{Assets_{j,t}} + \mu_{j,t}$$

Where:

$\beta_1, \beta_5$  = parameters estimated in equation

$\Delta TCA_{j,t}$  = Firm j's total current accruals in year t, = ( $\Delta CA_{j,t} - \Delta CL_{j,t} - \Delta Cash_{j,t} + \Delta STDEBT_{j,t}$ );

$\Delta CA_{j,t}$  = Firm j's change in current assets between year t-1 and year t;

$\Delta CL_{j,t}$  = Firm j's change in current liabilities between year t-1 and year t;

$\Delta Cash_{j,t}$  = Firm j's change in cash between year t-1 and year t;

$\Delta STDEBT_{j,t}$  = Firm j's change in debt in current liabilities between year t-1 and year t;

$Assets_{j,t}$  = Firm j's average total assets in year t and t-1; and

$CFO_{j,t}$  = Firm j's net cash flow from operation in year t.

$\Delta REV_{j,t}$  = Firm j's change in revenues in year t-1 and t; and

$PPE_{j,t}$  = Firm j's gross value of PPE in year t.

We formulate the OLS model for the regression analysis as follows; the functional model.

$$EQ_{it} = \alpha_0 + \alpha_1 Bsize_{it} + \alpha_2 PNEXECD_{it} + \alpha_3 NMEET_{it} + \alpha_4 SIZE_{it} + \alpha_5 LEV_{it} + \mu$$

Where:

$EQ_{it}$  = Earnings quality (EQ which is the residual-TCA)

$\alpha$  = intercept

$\alpha_1- \alpha_5$	=	parameters estimated in the equation
$i,t$	=	firm $i$ , time $t$
Bsize	=	size of the board
PNEXEC	=	proportion of nonexecutive directors on the board
NMEET	=	number of meetings held by the board
$\mu$	=	error term

SIZE and LEV are control variables.

Linear regression model was considered in this study; hence, the assumptions of this model are taken note of. The integrity of regression assumptions can be determined by considering residuals distribution and its relationships with other variables. The difference between the observed values of the dependent variable and the predicted values by regression line, which is the residual, was included. In regression analysis considering linearity, normality, stability of variance and independence of observations is of vital importance. In this research, these assumptions were considered.

### **3.7 . Variables measurement and Robustness Test**

This section gives a description and measurement of the variables as well as the robustness tests that was conducted in order to improve the validity of all statistical inferences for the study. These tests include; multicollinearity test, heteroscedasticity test, and Hausman specification test.

### **3.7.1 Multicollinearity test:**

This is to check whether there is a correlation between independent variables which will mislead the result of the study, thereby making the significance tests inappropriate and conclusions difficult to draw (Gujarati & Porter, 2009). To substantiate the lack of multicollinearity between the independent variables, colinearity diagnostics are observed and that the Variance Inflation Factors (VIF) and Tolerance Values (TV) are indicators as to whether multicollinearity exists in the data.

The tolerance value and the Variance Inflation Factor (VIF) are two advanced measures of assessing multicollinearity between the independent variables. Using SPSS, the variance inflation factors and tolerance values are computed and when found to be consistently smaller than ten and one respectively it shows the absence of multicollinearity (Neter, Kutner, Nachtsheim, & Wasserman, 1996 and Casey & Anderson 1999).

Furthermore, the data collected for the explanatory variable- earnings quality will be transformed using natural logarithm to do away with any outlier that might obstruct normality. Pauline & Mathews (2002) suggested that data transformation should be applied for skewed data set to eliminate outliers that exist within the huge data range from the larger to smaller. By doing so, it blends the data set to the

extent that will guarantee the details of each data taken in the statistical measurement.

### **3.7.2 Heteroscedasticity test:**

This test is conducted to check whether the variability of error terms is constant or not. The presence of heteroscedasticity signifies that the variation of the residuals or error term is not constant which could affect the inferences in respect of beta coefficient, coefficient of determination ( $R^2$ ) and F-statistic of the study. Therefore, Breusch-Pagan / Cook-Weisberg test are conducted for heteroscedasticity.

### **3.7.3 Fixed and Random Effect Test:**

This test is necessary as 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.

### **3.7.4 Variable definition and measurement:**

The table below show variables definition and measurement adopted in this study

**Table 3.1 contains the variables description and measurements**

<b>Variable Definition</b>	
<b>INDEPENDENT VARIABLES</b>	
Board Size	Number of directors on board
Proportion of Non-Executive Directors	Percentage of Non executive directors on the board of the firm
Number of Meetings	Number of meetings held by members of the board
Size of the Firm	Size of the firm
Leverage	Refers to the financial leverage of a firm
<b>DEPENDENT VARIABLE</b>	
Earnings Quality is the dependent variable and is being proxy by Total Cash Accruals	
<b>Variable Measurement</b>	
Board Size	Total number of directors on the board
Proportion of Non-Executive Directors	Number of non-executive directors divided by the total number of the directors on the board
Number of Meetings	Total number of meeting held by the board of directors

Size of the Firm	Log of total assets
Leverage	Bookvalue of long term debt divided by capital employed

**Source: by Author (2012)**

### **3.8 Summary**

This chapter considered the Correlation research design, population of the study is six quoted conglomerate firms as at 31 December, 2012, and all the six firms are studied. The dependent and independent variables used in the study are Earnings Quality as the dependent variable while board size, proportion of non executive directors and number of board meetings respectively. Method of data analysis was specified. It highlights the variables measurement, justification of the methodology and data description as well as the procedure of testing the hypotheses.

## **CHAPTER FOUR**

### **DATA PRESENTATION, ANALYSIS AND INTERPRETATION**

#### **4.1 Introduction**

In this chapter, the data collected for testing the research hypotheses are presented, interpreted and analysed. The results are presented based on the requirements of the research methods as outlined in chapter three. Tests are performed with the aim of achieving the set objectives of investigating the Impact of Board Supervision on Earnings Quality of Listed Conglomerate Firms in Nigeria, with a view to determining how board attributes used as proxies for board supervision have significant impact on earnings quality. The descriptive statistics of the data was first presented, which include summary statistics, correlation matrix, and various robustness tests adopted to ensure both internal and external validity. After presentation of the regression results, the major findings of the work are further discussed and analyzed. This is then concluded by documenting the policy implications as identified by this research.

#### **4.2. Data Presentation**

As previously mentioned, the data will be presented in three sections. First we begin with the descriptive statistics, which includes summary statistics,

correlation matrix as well as robustness tests. The summary statistics highlights the basic attributes of the data, the correlation matrix measures the relationships between all variables included in the regression model and the robustness tests are statistical tests adopted to check the reliability of the findings. Each result presented is followed by a detailed interpretation. Finally, the regression outputs are discussed. All output are obtained using STATA 10 statistical package. In addition, detailed results are attached in the appendices.

### 4.3. Descriptive Statistics

The descriptive statistics analyzes the basic feature of earnings quality together with other variables. It provides the basic insight into the nature of the data upon which analysis will be carried out upon. The statistics included in this work are the summary statistics, correlation matrix and other relevant robustness tests (multicollinearity, heteroscedasticity, and Hausman specification tests) carried out in this study.

*Table 4.3.1A: Summary Statistics of Earnings Quality and Economic Variables.*

	<i>EQ</i>	<i>BFSIZE</i>	<i>PNEXEDCD</i>	<i>NMEET</i>	<i>SIZE</i>	<i>LEV</i>
Mean	.2403437	8.619048	0.7357381	4.571429	10.01489	3.446512
Std.Deviation	0.370822	1.447494	0.0968031	1.19231	.380263	6.124499
Minimum	0.0016812	6	0.556	3	9.324	0
Maximum	2.179172	11	0.909	7	10.9568	24.1538

Obs.            42            42            42            42            42            42

*Source: Author's computation using STATA 10.*

Descriptive statistics for total companies (42 firm-year observations) have been represented in Table 4.3.1A. Earnings Quality (EQ) variable averaged approximately 0.24, standard deviation is 0.37, the minimum is 0.00 and maximum is 2.18. This means that investigated companies have had instability in the earnings quality during the research period. The Board Size (BSIZE) varies across the sample companies as the minimum is 6 and the maximum is as high as 11 members. The average board size is 9 having standard deviation of 1.45. An important factor that explains the disparity of the size of the board could be connected with the wide difference of the sampled company's sizes as represented by their total assets. Larger firms tend to have larger board size, which is a reflection of the firm's vast equity shareholding structure. Generally, Code of corporate Governance in Nigeria (2003) state that the Board should not to exceed 15 persons or be less than 5 persons in total.

PNEXEDCD which is a proxy measuring the Percentage of Non-executive directors on the board of the firm averages approximately 0.74 of the board of directors and with a standard deviation of 0.97. The minimum percentage of non-executive directors is 0.56, approximately ratio 4:7, of the entire board while the

maximum percentage is approximately 0.9, about ratio 10:1. This means that conglomerate firms have large percentage of non- executive directors.

The average Firm Size (SIZE) of the companies that are included in the sample, is represented by their total assets, and is approximately 10 Billion Naira. This reveals that sample companies for the period of the study have a fairly large capital base. The minimum is 9.3, maximum stand at 11.0 and standard deviation is 0.38. Summary results obtained also reveal that during the study period, number of board meetings (NMEET) held for same period averaged approximately 5 times for each of the sampled firms each year. Minimum and maximum number of meetings held each year was 3 and 7 respectively for the period under study and the standard deviation is 1.19. The Board of Directors of a listed company is supposed to meet at least once in every quarter of the financial year.

#### **4.3. 1A. Correlation Matrix**

The correlation matrix shows the relationship between all pairs of variables in the regression model. The relationship between all explanatory variables individually with explained variables and the relationship between all independent variables themselves. This essentially gives an insight into the magnitude of the pairs of independent variables in terms of their association with each other as excessive correlations can distort the standard errors of estimates and therefore

lead to incorrect conclusions. The correlation coefficient therefore could be used as an alternative test for multicollinearity as high correlation between the variables suggests the presence of contemporaneous correlation.

**Table 4.3.1B: Correlation Matrix**

	<i>EQ</i>	<i>BSIZE</i>	<i>PNEXEDCD</i>	<i>NMEET</i>	<i>SIZE</i>	<i>LEV</i>
<i>EQ</i>	<b>1.0000</b>					
<i>BSIZE</i>	0.4187*	<b>1.0000</b>				
	(0.0058)					
<i>PNEXEDCD</i>	0.3206*	0.6833*	<b>1.0000</b>			
	(0.0385)	(0.000)				
<i>NMEET</i>	0.1695	0.3553*	0.4360*	<b>1.0000</b>		
	(0.2831)	(0.0209)				
<i>SIZE</i>	-0.2161	0.3021	0.1710	0.4773*	<b>1.0000</b>	
	(0.1693)	(0.0518)	(0.2790)	(0.0014)		
<i>LEV</i>	-0.1123	-0.2493	-0.0900	-0.1498	-.3630*	<b>1.0000</b>
	(0.4789)	(0.1114)	(0.5709)	(0.3436)	(0.0181)	

*Source: Author's computation using STATA 10.*

In table 4.3.1 B above, the P- values are shown in brackets.

The correlation coefficients reveal that there are signs of correlation among the independent variables which could signal the presence of multicollinearity. All variables that have correlation coefficient less than 0.80 are considered safe and can therefore be included in the same regression model; Gujarati (2004).The correlation coefficient between BSize and *PNEXEDCD*, is positive and strong

(0.68). Therefore as the board size increases, the percentage Non-Executive directors/outside directors on the board, increases in the same proportion.

### 4.3.1C. Robustness Tests

The correlation coefficients in the table above show that multicollinearity does not exist. This research adopts further test for excessive correlation using the Variance Inflation Factor (VIF). The purpose of additional investigation is to provide adequate assurance that the research findings are robust to the model specification.

**Table 4.3.1C: Test for Multicollinearity**

	VIF	TV
<i>BSIZE</i>	2.08	0.468685
<i>PNEXEDCD</i>	2.13	0.480335
<i>NMEET</i>	1.56	0.641046
<i>SIZE</i>	1.51	0.661494
<i>LEV</i>	1.20	0.836475

**Source:** Author's computation using STATA 10.

As noted by Gujarati (2004), if the variables have VIF above 10, and tolerance values less than 0.10, there is a strong indication of the existence of excessive correlation. As reported in Table 4.3.1 C above, the tolerance value statistics are consistently greater than the common threshold of 0.10 (ranging from

0.46 to 0.83) and also the Variance Inflation Factor in relation to all the variables considered are consistently less than 10 (ranging from 1.20 to 2.13). These confirm the absence of multicollinearity in between the explanatory variables considered as such permitting the estimated coefficients to be determined.

#### **4.3.1D. Heteroskedasticity Test**

To test the existence of heteroskedasticity, the study uses the Breusch-Pagan/Cook Wiesberg test for normality of data. The Null hypothesis assumes that the variance of the residuals is constant. If the P value is significant at 0.05%, then there is substantial evidence to reject the null hypothesis, indicating the presence of Heteroskedasticity. The results reveal that  $\chi^2(1) = 52.19$ ,  $\text{Prob} > \chi^2 = 0.0000$ . This indicates that heteroskedasticity does exist, leading us to further perform fixed effect and random effect regression models.

#### **4.4. Presentation of Fixed Effects Model Regression Results**

Given the nature of the data, the OLS regression may not provide the required estimates. In order to examine whether endogeneity exists, which could potentially lead to biased coefficients, the study performs the Hausman specification test to make choice between the fixed and random effect regression models. This test is necessary, considering that there is a trade-off between the

efficiency of the random effect and the consistency of the fixed effects approach. The test also determines whether the estimates of the coefficient, taken as a group are significantly different in the two regressions. If variables are dropped in the fixed effect regression, they are excluded from the test. The aggregate null hypothesis is that *B*SIZE, *P*NEXEDCD, *N*MEET, *S*IZE, *L*EV, are exogenous. If the F statistic were significant, then the null hypothesis would be rejected, suggesting the presence of endogeneity. A significant result is obtained from the Hausman specification test which indicates that Chi2= 144.58 and Prob>Chi2= 0.0000, implying that the assumptions of the fixed effect approach is not violated and therefore is more suitable for this study. The fixed effect regression is considered appropriate because it takes into account both the temporal and spartial nature of the data (Sanda et.al 2008) in Ahmed (2013).

**Table4.4.1A: Fixed Effect Regression Results.**

Variable	Coefficient	Std. Error	T	P>/T/
Constant	8.5132	1.926863	4.42	0.000***
BSize	.1445379	.0697796	2.07	0.047**
PNEXECD	-1.087747	.8769224	-1.24	0.224
NMEET	.0771397	.0640311	1.20	0.237
SIZE	-.9086006	.163533	-5.56	0.000***
LEV	.0082863	.0113946	0.73	0.473

R <sup>2</sup> (within)	0.5355
R <sup>2</sup> (between)	0.0496
R <sup>2</sup> (Overall)	0.1810
F. stat	7.15
F. sig	0.0002***

*(\*\*\* and \*\* represent significant levels at 1% and 5% respectively).*

*Source: Author's computation using STATA 10.*

From the results obtained above, Bsize exhibits a positive and significant interaction with Earnings Quality, having a coefficient of 0.144 and t-value of 2.07. this implies that a 1% increase in Bsize, holding other variables constant, results in approximately 14% increase in the earning quality of the firms. Further analysis shows a significant positive impact between Bsize and Earnings Quality at 0.05% level. This is in line with our apriori expectation and as also found in Monks and Minow (2011) and Alzoubi (2012) which provides that larger boards are able to commit more time and effort, whereas smaller boards are able to commit less time and effort, to overseeing management This provides us enough evidence to reject the null hypothesis that Board size has no significant impact on earnings quality of listed conglomerate firms in Nigeria, lending support to the findings of Leng, & Li, (2011), Valahzaghhard, & Salehi, (2012). And recently, Salehi & Asgari (2013) also documented a significant positive impact of Bsize on

Earnings Quality, while contradicting the results of Bin, Hai, & Hui (2007), and Houqe, Zijl, Dunstan & Karim (2011).

The coefficient of PNEXECD is found to be negative -1.088 and a t-value of -1.24. This is however found to be statistically insignificant as shown by the P-value of 0.224. This is contrary to the apriori expectation of this study and contradicts the findings of Abdoli & Royae (2011) whose findings indicated that earnings quality increases in companies with higher proportion of non-executive directors. This study fails to document any convincing impact of non-executive directors on Earnings Quality of conglomerate firms in Nigeria for the period of this study. Finding of this study is also contrary to the findings of Salehi & Asgari (2013) who documented a positive relationship between earnings quality and non-executive directors. Thus we fail to reject the null hypothesis that Proportion of nonexecutive directors has no significant impact on earnings quality of quoted conglomerate firms in Nigeria. Our findings contradict the studies of Kangarlouei, Pakmaram, & Bayazidi (2012) and Fodio, Ibikunle & Oba (2013), Waweru, & Riro (2013), whose results indicated that there is a significant negative relationship between board independence and reported earnings quality.

The relationship between number of meetings (NMEET) and Earnings Quality is positive with a coefficient of 0.077, a t-value of 1.20 and P-value of

0.237. However this finding is not statistically significant as shown by the significance level of the P-value (0.237). Based on the above finding there is not enough evidence to reject the null hypothesis that the number of meeting has no significant impact on earnings quality of listed conglomerate firms in Nigeria. This lends support to the work of Mashayekhi & Bazaz (2010) where it was documented that number of meetings attended by board members has no significant impact on earnings quality.

Overall aggregate influence of Board supervision characteristics included in the model are able to explain Earnings Quality up to 0.18% which is indicated by the  $R^2$  (overall), while the remaining 81% are controlled by other factors that are not included in the model. The F statistic of 7.15 and significant at 1% shows that the model is fitted for the study and therefore provides substantial evidence that Board supervision impacts on Earnings Quality. This shows that the Board supervision variables investigated in this study have a significant aggregate impact on the quality of reported earnings of conglomerate firms listed on the Nigeria Stock Exchange.

#### **4.5 Test of Hypotheses**

The result of hypotheses stated in chapter one is presented on the table 4.5.1 below.

**Table:4.5.1A**

Variable	T -value	Sig
BSize	2.07	0.047**
PNEXECD	-1.24	0.224
NMEET	1.20	0.237
SIZE	-5.56	0.000***
LEV	0.73	0.473
F. sig	0.0002***	

*Source: Author's computation using STATA 10.*

The first hypothesis is stated as

**H<sub>01</sub>:** Board Size has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria.

Board size is an important element that impacts the effectiveness of board oversight duties. The size of the board of directors is important in effective supervision of the reported earnings of listed conglomerate firms. Board size, measured by the total number of board of directors in each of the firms under study, has a positive relationship and statistically significant at 5% level of significance. This relationship is contrary to our expectation but its statistical significance indicates that it does influence earnings quality. Therefore, the hypothesis stands to be rejected.

On the second hypothesis;

**H<sub>02</sub>:** Proportion of Nonexecutive Directors has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria.

Non-executive directors are seen as the checks and balances mechanism in enhancing boards' supervision effectiveness. Consequently, independent outside board members may play an important function in monitoring the production of financial statements by the management. As the board is viewed as a monitoring mechanism to safeguard shareholders' interests, a higher proportion of non-executive directors is preferable. Non-executive directors are preferable as they could increase the effectiveness of the board monitoring function and ensure high quality of reported earnings. From the hypothesis tested, PNEXECD has a positive relationship with earnings quality but not statistically significant (0.224) this finding is contrary to our expectation and it indicated that PNEXECD enhanced earnings quality through the board's supervisory role. Therefore the hypothesis stands not to be rejected

On the third hypothesis,

**H<sub>03</sub>:** The number of Board meetings has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria.

Meetings provide one type of opportunity for organizations to consult employees. They bring together interested parties who can express their views and to help to develop a common policy designed to achieve the organisation's objectives. Meetings are therefore an important administrative activity for board supervision; information can be exchanged, ideas passed and opinions expressed. They also play an important part in communicating information, providing a forum where problems can be solved and where decisions can be made by board members.

Often meetings are used to get collective decisions from members by democratic means. If an individual does not have the authority to make a decision, he or she might call a meeting so that others can agree to some proposals. Sometimes when a decision is made by a senior member of staff, it then needs ratification (confirmation) by others in a meeting.

As such, the hypothesis tested reveal that NMEET has a positive relationship with earnings quality of listed conglomerate firms in Nigeria but statistically insignificant. This clearly indicates that frequent meetings leads to higher earnings quality, this is because the board that meet frequently has time to report lapses seen in the management team and takes a proactive measures in ensuring that quality of earnings is not affected. Therefore, we fail to reject the hypothesis.

Summary of hypothesis testing is presented in Table:4.5.1B

**Table:4.5.1B Summary of Hypothesis Testing**

<b>Independent variable</b>	<b>Expected sign</b>	<b>Reported sign</b>	<b>Significant or not significant</b>	<b>Remark</b>
<b>Test of Hypothesis 1</b>				
Board Size has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria.	+	+	Significant @ 5%	<b>Rejected</b>
<b>Test of Hypothesis 2</b>				
Proportion of Nonexecutive Directors has no significant impact on Earnings Quality of Listed Conglomerate Firms in Nigeria	+	-	Not significant	<b>Accepted</b>
<b>Test of Hypothesis 3</b>				
The number of Board meetings has no significant impact on Earnings Quality of Listed Conglomerate	+	-	Not significant	<b>Accepted</b>

Firms in Nigeria.				
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Source: Result of the study (2015)

## 4.6 Discussion of major findings.

### 4.6.1. Board Size (*BSize*) and Earnings Quality (*EQ*)

The study provides evidence that board size is significantly and positively associated with discretionary accrual used as proxy for Earnings Quality. This indicates that larger boards are more effective in monitoring earnings; hence larger boards would reduce the extent of earnings manipulation by managers. This result is consistent with prior findings such as Karamanou & Vafeas (2005); Bradbury, Mak, & Tan, (2006) and Ismail, Dunstan, & Van Zijl, (2009), who provided evidence on the effectiveness of larger board size in reducing the extent of earnings manipulation. On the other hand, studies by Dimitropoulos & Asteriou (2010) and Sarikhani & Ebrahimi (2011) reveal that board size has no significant influence on earnings quality. The findings of these studies are consistent with the resource dependency theory perception of the role of larger boards in enhancing firm performance and accordingly reducing the incidence of earnings management.

### 4.6.2. Non-Executive Directors Composition (*PNEXECD*) and Earnings Quality (*EQ*)

The regression result reveals that non-executive directors as measured by the proportion non-executive directors on the board (PNEXECD) are negatively related and statistically insignificant with Earnings Quality. This means that companies with a higher composition of independent directors are less likely to engage in earnings management and therefore ensure higher Earnings Quality. It also shows that board of directors play important role in the supervision of financial reporting process. Lai (2011) in Waweru & Riro (2013) had also concluded that board independence, especially where the adoption of the independent directors was voluntary, reduces earnings management and increase earnings quality. A higher proportion of independent directors on the board leads to a better monitoring activity of the management (Booth et al. 2002). Consequently, independent outside board members may play an important function in monitoring the production of financial statements by the management (Mather & Ramsay 2006 and Frankel, McVay, & Soliman, 2011). Yung, (2013) also contended that if a company establishes independent directors or if the board comprises a higher proportion of non-executive directors, the earnings quality of the company should increase.

#### ***4.6.3. Number of Board Meetings (NMEET) and Earnings Quality (EQ)***

The relationship between NMEET and EQ is positive with a coefficient of 0.077 and a t-value of 1.20. Directors on boards that meet regularly are more likely to discharge their duties in accordance with interests of shareholders since more time can be devoted to monitoring issues such as Earnings Quality, conflicts of interest and monitoring management. On the other hand, boards that hardly ever meet may have no time to find out about such complex issues and may perhaps have time only to rubber stamp management plans. However, According to Murya, Lijuan, Aly, & Robert, (2014) board meeting is positively significant with the earnings management, the more frequently the board meetings are held, the earnings are prone to be manipulated under the modified Jones model with random effects when the year and industry factors are controlled.

#### **4.6. Policy Implications of Major Findings**

The findings of this study are both relevant to investors and regulators and those in the research arena regarding which board supervision mechanisms are more effective in improving the Earnings Quality. The study provides evidence that Board supervision impacts on the earnings quality of firms in Nigeria in different ways.

- i. Regarding Board Size, the findings of the positive and significant impact of the variable on EQ, provides evidence to both investors and regulators that

larger boards are associated with higher earnings quality of conglomerates in Nigeria. This is in line with the agency theory that larger boards are more likely to have members who possess financial expertise and could serve to align the interests of the managers with that of the shareholders.

- ii. This result is very relevant to the Securities and Exchange Commission (SEC) to continuing devising and implementing best governance practices in companies, regarding the size of the board of directors that will reduce the conflicts between owners and managers of resources and ensuring fair playing ground for all stakeholders.

## **4.7 Summary**

This chapter presented the result of descriptive statistic obtained from the STATA 10 output in a tabular form. A summary of the estimated regression result was also presented. The results from the findings are discussed in turn.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1. Summary**

The role of board supervision in checking or ensuring the quality of reported earnings has taken the centre stage of academic discussion following various corporate failures that have plagued various companies across the country and the globe at large. The study focuses on the manufacturing sectors especially conglomerate firms that are listed on the Nigerian Stock Exchange (NSE). The objective of the study was to determine the impact of board supervision on earnings quality of listed conglomerate firms in the Nigeria Stock Exchange as at 31 December 2012. The scope of the study covers a period of seven years, 2006 to 2013. The choice of the period and the firms included in the analysis was guided by data availability considerations. Also, by focusing on the 6 listed conglomerate firms, we identify a suitable context in which earnings management may be more easily carried out. This is so, if one considers the inter-woven relationships between the mother firms and their subsidiaries both of which are listed in the exchange. Most of the world's monumental frauds and remarkable earnings management incidences were carried out by conglomerate giants.

Correlation research design was used, formulated Hypotheses were tested appropriately and data was presented using descriptive statistics.

However, the study discovered that efficient monitoring from non-executive directors that are free from managerial influence is capable of improving the earnings quality. Board Size is significantly and negatively associated with Earnings Quality, Proportion of Non-Executive Directors is negatively related and statistically insignificant with Earnings Quality; while Directors that meet regularly are more likely to discharge their duties in accordance with interests of shareholders as more time can be devoted to monitor issues such as Earnings Management.

## **5.2 Conclusions**

This study provides evidence for the existence of the link between firm's earnings quality and firm's board supervision. Specifically, we investigate whether the mechanism of board supervision affects accruals quality. Using data obtained from conglomerates listed on the Nigerian stock exchange the study shows that as board size increases, so does the earnings quality as measured by the discretionary accruals. Marjan, & Rashidah,. 2013 believed that large boards are beneficial for the broader range of experiences and the varied expertise that they bring to the decision-making process via frequent meetings. They suggested that a larger board

is more effective in preventing corporate failure. However, the study discovered that a large board size may make it difficult for members to have efficient communication and to achieve a consensus.

One can confirm that prior research supports the hypothesis that earnings management is reduced in proportion to the number of Non-executive directors on the board. This suggests that Non-executive directors improve earnings quality by reducing earnings management. Firms with higher earnings quality are seen by investors as being more transparent (Hodge 2003). Thus there could be a substitution effect with earnings quality and the level of independent directors on the board (Bushman et al. 2004). If the firm is more transparent, there is probably less need for board supervision and monitoring and independent director membership.

However, the findings do not show any significant relationship with PNEXECD (proportion of non executive directors). The same results have been obtained for board meetings (NMEET) as well.

#### **5.4 Recommendations**

Based on the findings of this study, the following recommendation is proffered.

i. Some of the existing literature believes that smaller boards are easier to coordinate; quicker in making decisions; less likely to have free-rider problems; and less likely to oppose innovation (Dimitropoulos & Asteriou 2010). Smaller boards also facilitate the influential exchange of ideas between the firm and its directors and are less likely to exacerbate the coalition costs among board members (Vafeas 2000). Consistent with these assertions, Cho & Rui (2009) and Vafeas (2000) provide empirical evidence that firms with smaller boards experience earnings numbers of high quality. On the contrary, larger boards are viewed as having expert board members, especially those who are independent and can provide environmental links. Studies concerning financial reporting quality conclude that managers of firms with larger boards are less expected to engage in opportunistic behavior of earnings management that may deteriorate the quality of earnings numbers to interested parties (Bradbury et al. 2006; Ismail et al. 2009).

On the other hand, studies by Dimitropoulos & Asteriou (2010) and Sarikhani & Ebrahimi (2011) reveal that board size has no significant influence on earnings quality. This is in line with our findings and contrary to our expectation. Therefore, we recommend a decrease in board size which the current study shows, averaged 8 to 6 for easy

coordination and effective supervision which can impact on earnings quality

- ii. Proportion of non-executive directors is viewed as a monitoring mechanism to safeguard shareholders' interests. Literatures show that a higher proportion of non-executive directors is preferable. Non-executive directors are preferable as they could increase the effectiveness of the board monitoring function (Gupta & Fields, 2009; Jaggi, et al., 2009) and ensure high quality of reported earnings. Non-executive directors are seen as the check and balance mechanism in enhancing boards' supervision effectiveness. Consequently, non-executive directors may play an important function in monitoring the production of financial statements by the management (Frankel et al. 2011; Leng & Chang, 2011).

The study reveals that Board independence is positively related to earnings quality, though, statistically insignificant. The finding of this study is consistent with the resource dependency theory perception of the role of larger boards in enhancing firm performance and accordingly reducing the incidence of earnings management. The result of the study shows that proportion of non-executive directors averaged 73%.this can be increased to 80% for efficiency and better reporting quality.

iii. Meetings are forums where ideas are exchanged, policies designed and control measures in achieving the set objectives discussed. Meetings often show a signs of serious business minded directors. Directors on boards that meet regularly are more likely to discharge their duties in accordance With interests of shareholders since more time can be devoted to monitoring issues such as Earnings Quality, conflicts of interest and monitoring management (Ebraheem, 2012). Xie et al. (2003) argued that a board that meets rarely may only have time for signing off management plans and listening to presentations; hence, they may not have time to focus on issues such as Earnings Quality. Adams et al. (2008) found that directors who primarily monitor management perceive that they participate less in boardroom discussion than other directors. Our study further reveals that the studied firms board meetings averaged 4 times per annum. It should be ensured that meetings are held at least once in every month as obtained in Iran and members be compelled to have not less than 80% attendance (Abdoli & Royae, 2011).

## **5.5 Limitations of the Study**

This work provides an approach to establishing the impact of Board supervision on Earnings Quality of conglomerate firms in Nigeria, caution should be exercised in

using the results and findings of this work as a basis for generalization. This is due to the fact that the work is not completely free from limitations stated below in terms of practical applicability.

- i. First only listed conglomerate companies have been included in the study. Restricting the study of quality of reporting to publicly traded corporations excludes a significant and most efficient institutional arrangement for undertaking Productive activities.
- ii. The second limitation of this study is the relatively small sample size of six (6) listed conglomerate firms. Due to this limitation, any generalization of findings to all firms might be biased to the sample chosen. A larger sample size would provide a more comprehensive set of findings and allow for more robust interpretations for this study.
- iii. Though this study attempts to control for the factors suggested by prior studies, there are still some other factors (e.g. culture and other aspects of board supervision) that have not been controlled.
- iv. The findings of the present study may not be applicable to other developed countries due to their technological advancement and quality of expertise there. We in the third world still find ourselves trailing behind these countries

- v. In studies of this nature, there is always the possibility of omitted variables, with respect to the model developed and employed in the works that have a bearing on earnings quality. However various regression diagnostics have been performed in order to check the possibility of excessive correlation, including the hausman specification test.

## **5.6 Areas for further research**

The results of this study provide evidence that certain Board supervision variables impact on earnings quality of conglomerate firms in Nigeria. However, there are several areas that are not explored by this research that could be relevant to the role of board supervision in improving the earnings quality of conglomerate firms in Nigeria. Below are areas for further research:

- i. We recommend a replication of this research to other sectors of the economy like banking and non-financial institutions as this sector is easily prone to earnings management.
- ii. Future research might need to investigate other manufacturing sectors in Nigeria and governance dynamics such as ownership concentration, board diversity, and institutional investors, and audit committee diligence /

expertise. Some of the variables are not used in this study due to scanty information on such variables.

iii. Similarly, there is the need to study the effect of IFRS adoption on earnings quality in Nigerian Firms. It is relatively a new area of research in developing economies. This field is not yet exploited in Nigeria to the best knowledge of the author. Hence it is recommended as a potential area for further research.

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## **Appendix I**

### **Conglomerates Firms Listed at Nigeria Stock Exchange as at 31December 2012**

1. A.G. LEVENTIS NIGERIA Plc.
2. CHELLARAMS Plc
3. JOHN HOLT Plc.
4. S C O A NIG. Plc.
5. TRANSNATIONAL CORPORATION Plc
6. U A C N Plc

## Appendix II

. summarize EQ BSize NEXECD NMEET SIZE LEV

Variable	Obs	Mean	Std. Dev.	Min	Max
EQ	42	.2403437	.370822	.0016812	2.179172
BSize	42	8.619048	1.447494	6	11
NEXECD	42	.7357381	.0968031	.556	.909
NMEET	42	4.571429	1.19231	3	7
SIZE	42	10.01489	.380263	9.324	10.9568
LEV	42	3.446512	6.124499	0	24.1538

. pwcorr EQ BSize NEXECD NMEET SIZE LEV, star (0.05 )sig

	EQ	BSize	NEXECD	NMEET	SIZE	LEV
EQ	1.0000					
BSize	0.4187* 0.0058	1.0000				
NEXECD	0.3206* 0.0385	0.6833* 0.0000	1.0000			
NMEET	0.1695 0.2831	0.3553* 0.0209	0.4360* 0.0039	1.0000		
SIZE	-0.2161 0.1693	0.3021 0.0518	0.1710 0.2790	0.4773* 0.0014	1.0000	
LEV	-0.1123 0.4789	-0.2493 0.1114	-0.0900 0.5709	-0.1498 0.3436	-0.3630* 0.0181	1.0000

. reg EQ BSize NEXECD NMEET SIZE LEV

Source	SS	df	MS	Number of obs = 42		
Model	2.03129639	5	.406259279	F( 5, 36) =	4.06	
Residual	3.6065708	36	.100182522	Prob > F =	0.0051	
				R-squared =	0.3603	
				Adj R-squared =	0.2714	
Total	5.63786719	41	.137508956	Root MSE =	.31652	

  

EQ	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
BSize	.1224364	.0492737	2.48	0.018	.0225046	.2223681
NEXECD	-.1378318	.7458891	-0.18	0.854	-1.650565	1.374902
NMEET	.075744	.051781	1.46	0.152	-.0292727	.1807607
SIZE	-.5121927	.1598295	-3.20	0.003	-.836342	-.1880434
LEV	-.0091163	.0088248	-1.03	0.308	-.0270139	.0087813
_cons	4.101181	1.567477	2.62	0.013	.9221898	7.280173

. hetttest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of EQ

chi2(1) = 52.19  
 Prob > chi2 = 0.0000

. xtreg EQ BSize NEXECD NMEET SIZE LEV, re

Random-effects GLS regression                      Number of obs = 42  
 Group variable: id                                    Number of groups = 6

R-sq: within = 0.3854                                Obs per group: min = 7  
           between = 0.3388                                avg = 7.0  
           overall = 0.3603                                max = 7

Random effects u<sub>i</sub> ~ Gaussian                      Wald chi2(5) = 20.28  
 corr(u<sub>i</sub>, X) = 0 (assumed)                            Prob > chi2 = 0.0011

EQ	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
BSize	.1224364	.0492737	2.48	0.013	.0258616	.2190111
NEXECD	-.1378318	.7458891	-0.18	0.853	-1.599748	1.324084
NMEET	.075744	.051781	1.46	0.144	-.0257448	.1772329
SIZE	-.5121927	.1598295	-3.20	0.001	-.8254528	-.1989325
LEV	-.0091163	.0088248	-1.03	0.302	-.0264127	.0081801
_cons	4.101181	1.567477	2.62	0.009	1.028982	7.173381
sigma_u	0					
sigma_e	.26062261					
r <sup>2</sup> o	0	(fraction of variance due to u <sub>i</sub> )				

```
. xtreg EQ BSize NEXECD NMEET SIZE LEV, fe
```

```
Fixed-effects (within) regression      Number of obs   =    42
Group variable: id                    Number of groups =     6

R-sq:  within = 0.5355                 Obs per group:  min =     7
      between = 0.0496                   avg             =    7.0
      overall  = 0.1810                   max             =     7

corr(u_i, Xb) = -0.5605                F(5, 31)        =    7.15
                                           Prob > F         =    0.0002
```

EQ	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
BSize	.1445379	.0697796	2.07	0.047	.0022214	.2868544
NEXECD	-1.087747	.8769224	-1.24	0.224	-2.876243	.7007476
NMEET	.0771397	.0640311	1.20	0.237	-.0534526	.207732
SIZE	-.9086006	.163533	-5.56	0.000	-1.242128	-.575073
LEV	.0082863	.0113946	0.73	0.473	-.0149532	.0315258
_cons	8.5132	1.926863	4.42	0.000	4.583337	12.44306
sigma_u	.32346408					
sigma_e	.26062261					
rho	.60635814	(fraction of variance due to u_i)				

```
F test that all u i=0:      F(5, 31) =    4.42      Prob > F = 0.0037
```

```
. hausman fixed random
```

	Coefficients		(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
	(b) fixed	(B) random		
BSize	.1445379	.1224364	.0221015	.0494095
NEXECD	-1.087747	-.1378318	-.9499157	.4611316
NMEET	.0771397	.075744	.0013957	.0376658
SIZE	-.9086006	-.5121927	-.396408	.0346057
LEV	.0082863	-.0091163	.0174026	.0072083

b = consistent under Ho and Ha; obtained from xtreg  
 B = inconsistent under Ha, efficient under Ho; obtained from xtreg

Test: Ho: difference in coefficients not systematic

```
chi2(5) = (b-B)'[(V_b-V_B)^(-1)](b-B)
          =    144.58
Prob>chi2 =    0.0000
(V_b-V_B is not positive definite)
```