

**MODERATING EFFECT OF FREE CASH FLOW ON THE RELATIONSHIP
BETWEEN OWNERSHIP STRUCTURE AND EARNINGS MANAGEMENT OF
LISTED DEPOSIT MONEY BANKS IN NIGERIA**

BY

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AHMADU BELLO UNIVERSITY,
ZARIA, NIGERIA**

AUGUST, 2018

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**DEPARTMENT OF ACCOUNTING
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ZARIA**

AUGUST, 2018

DECLARATION

I hereby declare that this thesis entitled “Moderating effect of Free Cash Flow on the relationship between Ownership Structure and Earnings Management of Listed Deposit Money Banks in Nigeria” has been carried out by me in the Department of Accounting. The information derived from the literature has been duly acknowledged in the text and list of references provided. No part of this work was previously presented for another degree or diploma at this or any other institution.

Aliyu IDRIS

Date_____

CERTIFICATION

This Thesis entitled MODERATING EFFECT OF FREE CASH FLOW ON THE RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND EARNINGS MANAGEMENT OF LISTED DEPOSIT MONEY BANKS IN NIGERIA by ALIYU IDRIS meets the regulations governing the award of Doctor Of Philosophy (Ph.D) in Accounting And Finance of the Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This work is dedicated to the Almighty Allah for making it possible for me to complete this programme and my immediate family for their perseverance and encouragement throughout my programme.

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ABSTRACT

The crises in Nigeria deposit money banks (DMBs) and inconsistency in the findings of the preceding studies practically motivate the study. Therefore, the study examine the moderating effect of the free cash flow on the relationship between Ownership Structure and Earnings Management (EM) of listed DMBs in Nigeria. The population and sample of the study comprises the fourteen DMBs listed on the Nigerian Stock Exchange (NSE). The study uses data from published annual report of the fourteen DMBs listed on the Nigeria Stock Exchange for the period of 2007 to 2016 and carry out different tests including Hausman specification test and Lagrange multiplier test which specify that OLS regression analysis is efficient. The findings reveal that the executive director ownership (exed) and ownership concentration (ownc) are positive and significantly related to EM. The result also shows that non- executive director ownership (nexed), institutional (instow) and foreign ownership (forown) are negative and significantly related to EM. It further reveals that the free cash flow moderate the relationship between executive director ownership, non- executive director ownership and institutional ownership. It is therefore conclude that ownership structure influences earnings management. While the exed and ownc manipulate accounting information, the nexed, instow and forown provide monitoring mechanism against EM. The study recommends, among others, that the codes of corporate governance for DMBs should be reviewed to discourage executive director from earnings manipulation, encourage more non- executive director ownership, long term institutional ownership and foreign ownership holdings in DMBs to intensify their monitoring mechanism against earnings management. The utilization of free cash flow source internally or externally in Nigeria DMBs should be regulated to discourage over- trading or over investment so as to avoid earnings management.

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CHAPTER ONE: INTRODUCTION

1.1 Background to the Study

The deposit money banks (DMBs) are financial institutions whose major operations and source of revenue are the loans and deposits respectively. The banks obtain funds from the surplus unit and create risk assets with the funds at the deficit unit which attract interest. The major source of earnings in the DMBs is the interest accrued from the quality risk assets. However, the banks are confronted with the challenge of poor quality risk assets as a result of weak corporate governance which result in high loan loss provisions, liquidity problem and capital depletion (CBN Special Audit Report, 2009). Although, the banks in the last decades have been reporting a clean bill of health on the performance of the loans and their earnings in the financial statements but the issue of high non –performing loan which made Central Bank of Nigeria (CBN) to direct banks to make additional loan loss provision in 2017 has been raising concern on the reliability of accounting information.

The integrity and quality of accounting information for decision making by account users have become contemporary issues among researchers, academicians and regulators. This is not unconnected with the fact that managers tend to use general accrual method, real earnings management and specific accrual technique to manipulate financial information for their selfish interest (Cohen & Zarowin, 2010). However, the manipulation of accounting information has reduced the confidence of the stakeholders in relying on the financial statements for decision making. The accounting information which is a medium for communicating the financial performance of the firm to the stakeholders has therefore become a tool for misleading the stakeholders in decision making. One of the stakeholders who rely on financial statements for decision making are the shareholders who entrust their resources in the hands of the managers with the expectation to maximise their wealth and report back within a stipulated time through financial reporting. This important objective of

wealth maximization places managers on target to pursue the goal and report back the scorecard to the shareholders to sustain their careers. This target therefore put the managers on pressure to satisfy the shareholder therefore engage in account manipulation. Managers engage in accounting manipulation using different dimensions. For example, in manufacturing firms, reported earnings are manipulated through aggregate accruals to distort reported earnings while those in the banking industry use specific accrual technique such as Discretionary Loan Loss Provisions (DLLP) to manipulate the financial statements (Alina & Dan, 2014).

The earnings management in DMBs is done by managers through the manipulation of loan loss provisions, that is, general provisions and specific provisions. The general LLP is provided immediately facilities are created while the specific LLP is provided when there is a trace of default on a specific facility. In prudential guidelines, managers are required to provide for 1% of the facilities immediately the loan is created while the specific LLP requires managers to classify facility as sub-standard which give room for 20% provision if the customer fails to repay the facility between 90 days and 180 days from the date the loan is granted. Conversely, if the customer defaults repayment of principal and interest within 180 days and 360 days, the managers are expected to classify the loan as doubtful and make provisions for 50%. Similarly, the loan is considered bad if the customer default repayment of the principal and interest beyond 360 days and therefore write – off or charge – off the loan from the book (CBN Prudential guideline, 2009). These provisions are required to discourage managers from presenting fictitious or paper profit to the shareholders and to make the banks avoid creating bubbles in financial assets. Despite this prudential guidelines, bank managers make general provision for 1% and decide what to do with the provisions either to adjust the reported earnings upward or downward (CBN Special Audit Report, 2009).

The incentive is to change the risk perception or manage trend of earnings over time. It helps managers in reducing the stock price variability, regulatory constraint in dividend payment or borrowing and handling agency or compensation problem. However, the concern has created a conflict of interest between the owners of the firms and the managers which increases agency cost. Consequently, regulators appreciate that conflict of interest exist in the system and the quest for good corporate governance has become the dominant theme in global economic issues. The reason is not far-fetched because most of the adverse consequences created by the global financial crisis are direct fall-out of sloppy corporate governance regimes (Garuba & Otomewo, 2015).

Corporate governance is a philosophy and mechanism that defines the operational activities and structure of organizations which facilitate in the creation of shareholder value through management of corporate activities. It is therefore created to ensure the protection of individual and collective interest of all the stakeholder in the firm (Garuba & Otomewo, 2015).

The code of corporate governance gives room for insider holdings, outsider holding, institutional holding and foreign holding. The ownership structure includes the executive director ownership, non – executive director ownership, ownership concentration, institutional ownership and foreign ownership. Ownership structure is designed to monitor the activities of the managers in the applications of current accounting practices which gives room for accounting numbers, choice of accounting policies and professional judgment in the criteria for recognitions and measurements of accounting information. Managers exercise these choices by intentionally refusing to disclose some information that are vital for decision making and therefore manipulate accounting figures to make business appear more profitable (Akenbor & Ibanichuka, 2012).

Corporate governance presumes that ownership structure gives opportunity to the executive director, non- executive directors, institutions, foreign investors to hold stake in the DMBs and also allow ownership concentration. The stake holdings by the insiders helps in providing monitoring mechanism to curtail the manipulation of accounting numbers by the managers, even though, the effectiveness of ownership structure depends on the percentage of holdings by such managers. If the holdings of the executive director is not substantial enough, the workability of the corporate governance by them regarding monitoring mechanism is far from being achievable. Also the number of non- executive director who have stake in the bank are expected to be vigorous in providing adequate monitoring mechanism to the activities of the managers. The influence of the non- executive directors on the activities of the managers depends on how high or low they are present on the board and the quality of representation. Likewise, the institutional ownership influences on the financial reporting depends on whether the investment is for a short-term or long-term, while ownership concentration inspirations on the earnings management depend on whether the concentration is in the hand of few or not. However, foreign investors are expected to deploy their technical expertise to monitor the activities of the managers in relation to account manipulation (Suwandi, Cape & Abdulhamid,2015).

It is also worthy to note that, the regulators are yet to look at other issues such as free cash flow which impede the workability of corporate governance in DMBs because free cash flow in a low growth bank lead to over investment or over- trading which result in earnings management. It is the presence of cash available after all profitable projects have been financed which are yet to be distributed as dividends or super-dividends. Logically, it is believable that free cash flow have potential to influence agency cost when managers engage in unprofitable projects for their selfish interest. The free cash flow has been suggested to moderate the relationship between ownership structure and earnings management

(Redwhan& Ku, 2011). Despite a very thorough literature search, no study is found to have tested this indirect relationship particularly in the context of DMBs in Nigeria. Hence, this unfill gap become important in this study.

Managers are disposed towards squandering internally generated cash flow that is excess of what is needed to maintain the existing assets in place and finance profitable projects, when their objectives differ from those of shareholders (Yero & Usman, 2017). However, the carefulness of the executive directors in the investment of the surplus cash flow depend on their stakes in the bank. If the executive directors have high stakes in the bank, the tendency to under – utilize the free cash flow will be low compared to when the stakes are insignificant. Also, the non- executive directors’ ability to detect the presence of free cash flow in the system depends on his technical and professional capability, since they are not involve in the accounting process. Although, the technicality and financial capacity of the institutional investors are expected to be good enough to detent the free cash flow situation and provide remedial solution to inhibit earnings management, the presence of free cash flow available in the banks have serious influence on the behaviour of the directors and other stakeholders in accounting manipulation. It is necessary to disentangle the interference of the free cash flow in the system to free the workability of corporate governance. Therefore, this study examines the moderating role of free cash flow on the ownership structure and earnings management of DMBs in Nigeria.

1.2 Statement of the Problem

This study is motivated by the issue of account manipulationby managersof deposit money banks (DMBs) in Nigeria.According to CBN and NDIC joint audit of (2009), the account manipulation is predicated on the weak corporate governance and risk management whichled to a huge loss of investment by the shareholders of DMBs in Nigeria to a tune of N2. 216 trillion between 2007 and 2009. The predicament arise from illegal manipulation of

accounts by managers, poor reporting system, speculations of depositors' funds in the capital market, insider lending, compassionate lending of loans to families and friends without due diligence, inadequate disclosure and transparency. The consequences of these accounting manipulation by the managers of DMBs in Nigeria in the last fifteen years has led to liquidations, loss of identities resulting from mergers and acquisitions and taking over of some DMBs by Assets Management Corporation of Nigeria (AMCON). Example of such banks were Oceanic bank, Intercontinental bank, bankPHB, Afri bank among others (Senusi, 2010).

However, part of this problem was blamed on the poor ownership structure as Chief Executives of some banks such as Oceanic bank and Intercontinental bank were still carrying out business without recourse to corporate governance even after listing the bank on the Nigeria Stock Exchange (NSE) as a Public Liability Company (CBN & NDIC joint audit, 2009). The problem of account manipulation by managers of DMBs in Nigeria is yet to be over as at today. It is easy to believe that if directors (executive and non- executive) were having substantial equity stake in those failed banks, they wouldn't have allowed or tolerated the acts of the CEO without sacking them for financial embezzlement, theft and misconduct. Hence, non or low ownership causes the said poor bank performance.

Lately, CBN raises concern on how DMBs in Nigeria are engaged in unethical acts such as recognition of unrealisable income, inappropriate written off debt, under provision for bad and doubtful debt, restructuring of bad loans, moratorium given to customers who are technically insolvent to service their loans as at when due and non- disclosure of bad debt recovery at the appropriate time. The manipulation of account information by managers of DMBs in Nigeria for their selfish interest has no doubt led to grave financial uproar in the sector. The financial crisis includes high non- performing loans, borrowing of working capital from CBN, depletion of tier 1 capital and liquidity crunch. In 2015, Enterprise bank

had a high non – performing loan which led to its acquisition by Heritage bank. In 2017, the management of Skye bank was disengaged and replaced with new management as a result of insider dealing. The bank was further directed to make additional loan loss provision for high non – performing loan. Currently, Keystone, Heritage and Unity bank are borrowing funds from CBN to meet up with their current obligations. The banks could not meet up with working capital because of high bad debt written off. Therefore, the issue of quality account information in DMBs is still persisting. To curb the above mentioned problems, the CBN and SEC re-introduced code of corporate governance in 2006 and 2009 respectively part of which is ownership to curb the aforementioned problems but the problem is still persisting.

Theoretical, crises like these attracted the attention of researchers such as Koh(2003); Chung, Firth and Kim (2005), Nedal, Bana and David (2010); Reyna (2012); Elizah and Isenmila (2012); Alves (2012); Ahmed and Iwasaki (2015) to examine the workability of ownership structure in curbing the earnings management but the findings from these studies are inconsistent. The findings from the works of Koh (2003); Chung, *et al.* (2005), Nedal *et al.* (2010); Reyna (2012) reports positive relationship between ownership structure and earnings quality of the firms while that of Elizah and Isenmila (2012); Alves (2012); Ahmed and Iwasaki (2015) confirms a negative relationship between ownership structure and earnings management. The negative relationship signifies that ownership structure plays a vital role in inhibiting earnings management in the firms but the study by Neda *et al.* (2010) find that the relationship between ownership structure and earnings management is inconclusive. The above studies only limit their investigation to the ownership structure without considering the interaction of other factor such as free cash flow which provides surplus funds to support reported earnings.

Based on the aforementioned inconsistent findings, FCF is adopted to moderate the relationship between ownership structure and earnings management in DMBs as suggested

by (Redwhan & Ku, 2011). The presence of free cash flow in the bank increases agency cost if the free cash flow available in the low growth banks is not used to pay dividend to the shareholders. However, the free cash flow moderate the relationship between ownership structure and earnings management if the surplus funds available in the bank is used for the payment of dividend. The omission of free cash flow therefore serve as a serious weakness in the prior studies because there are evidences that free cash flow is used for earnings manipulation in the work of Chung *et al.* (2005); Jaggi and Gul (2000); Bukit and Iskandar (2009) and Rusmin, Etime and Hartadi (2014) which confirm that managers use free cash flow to manipulate earnings.

However, it is pertinent to note that the only study conducted by Redwhan and Ku (2011) in Malaysia investigates the relationship between ownership structure and earnings management using free cash flow as a moderator. Although, the variables used in the study are institutional ownership and managerial ownership, the study did not explore the moderating role of free cash flow on the relationship between executive director ownership, non-executive director ownership and earnings management and the study is conducted in non-financial institution. The studies on earnings management in non-financial institutions cannot be generalized in DMBs because of the discrepancies in the measurements. While non-financial institutions used aggregate accruals such as change in revenue, change in receivables, properties, plant and equipment and depreciation in the measurement of earnings management, DMBs used discretionary LLP. Therefore, this study attempt to fill the gap by exploring the moderating role of free cash flow on the relationship between ownership structure and earnings management. This gap makes the work original and different from other studies.

Notwithstanding the efforts made by the prior researchers in curbing earnings management through ownership structure, the problems still persist and the academicians or

researchers could not confirm its workability due to the inconsistent findings. In the light of the forgoing, the study takes a step further to fill the gap by determining the moderating role of free cash flow on the relationship between ownership structure and earnings management. The study uses free cash flow to moderate executive director ownership, non-executive director ownership and institutional ownership in relation to earnings management. This makes the study unique and original by extending the body of knowledge in this aspect. This study also aimed at filling some theoretical gaps lying in the literature.

Firstly, agency theory suggests that a separation of ownership from control increases agency cost and predict that if more shares are given to the insiders the issue of conflict would be drastically reduced, therefore an inverse relationship between insiders' ownership and account manipulation is expected. In line with this thought, prior researchers such as Koh(2003); Nedal *et al.* (2010); Elizah and Isenmila (2012); Reyna (2012); Alves (2012); Zubair (2014); Lawal (2015) subject this premise to test using managerial ownership or director ownership and block-holder ownership. The study examine the directors' ownership in relation to earnings management empirically without considering the executive director ownership and non- executive director ownership separately. While the executive directors' benefit is a function of the reported earnings because of the compensation plan, the non – executive directors with stakes in the firm rely only on the allowances and what comes to them from firms as dividend. It is therefore observed that only a few studies examine the relationship between executive director ownership, non-executive director ownership and earnings management in DMBs in the prior studies. Therefore, this study hypothesizes the nexus between executive director ownership, non- executive director ownership and earnings management in the banking industry because of the dearth of research in this area.

Second, the efficiency monitoring hypothesis in agency theory suggests that monitoring by institutional ownership can be an important governance mechanism in

improving the quality of earnings because, the institutional investors can provide active monitoring mechanism that is difficult for smaller, more passive or less-informed investors (Almazan, Hartzell & Starks 2005, as cited in Alves 2012). It further presumed that investors have the opportunity, resources, and ability to monitor, discipline, and influence managers of firms (Monks & Minow, 1995). The passive hypothesis assumes that short term investors see monitoring cost as a waste and ready to divert their investment from poor performed firms to good performed firms. Therefore, the relationship between institutional ownership and earnings management is expected to be positive or negative. To confirm this deduction, the studies such as Chung, Firth and Kim (2002); Yeo, Tan, Ho and Chen (2002); Vehury and Jinkins (2006); Koh (2007); Muhammed (2010); Alves (2012); Al –Zoubi and Salemat (2012); Hsu and Wang (2014); Lin and Manowan (2012); Mbogela and Swai (2016) evaluate the nexus between institutional ownership and opportunistic accounting. The findings from these studies are mixed. Accordingly, some studies for example Muhammed (2010); Elizah and Isenmila (2012); Alves (2012); Lin and Manowan (2012) empirically document a positive relationship between institutional ownership and earnings management while other studies for instance Vehury and Jinkins (2006); Koh (2007); Nedal, *et al.* (2010); Mbogela and Swai (2016); Al –Zoubi and Salemat (2012); Hsu and Wang (2014) provide inverse relationship between institutional ownership and earnings management. Therefore, there is need to confirm as to whether DMBs in Nigeria have short term investors who do not provide monitoring mechanism to reduce earnings management.

Third, the spill over hypothesis predicts that the superior knowledge of foreign investors can curtail the opportunistic behaviour of the managers because they can be seen as an effective mechanism that could complement the governance structure to monitor the management from non – value maximum activities because their role resemble that of institutional investor (Dahquest & Robertson as cited in Ali, Salleh & Hassan 2008). Despite

the postulations of the agency theory and spill over hypothesis which predict an inverse relationship between foreign ownership and earnings management, the findings of the prior studies do not provide consensus results. The studies of Aharony, Lee and Wong as cited in Idris (2012); Ali et al. (2008); Kim and Soon (2008); Idris (2012) report positive relationship while that of Ahmed and Iwasaki (2015); Guo, Hang and Zhang (2015); Anwer and Takuya (2015); Adebisi and Olowookere (2016) document evidences of inverse relationship, the studies of Ali *et al.* (2008) and Suwandi, Cepi and Abdulhamid (2015) are inconclusive.

From the above, it is obvious that the postulation of agency theory and the focus of corporate governance is yet to be confirmed true as the prior empirical studies review show mixed findings. Some findings present inverse relationship while some studies present positive relationship, other studies are inconclusive. The discrepancies arise from differences in domain, measurement and regulatory environment. Majority of these studies are conducted in the developed economies. Only a few studies evaluate the relationship between foreign ownership and earnings management in Nigeria and majority of them are not in DMBs. This gap therefore confirmed dearth of studies in this area. In view of this regards, the need to subject the relationship between foreign ownership and earnings management to test cannot be over-emphasised, hence this study chooses to hypothesize it.

Forth, the issue of whether high degree of ownership concentration lead an increase in agency conflict is still debatable in the academic literature. While the studies of Morck, Shleifer and Vishny (1988); Fang and Wong (2002); Leuz, Nanda and Wysocki (2003); Hu and Izumida (2008); Gebhardt and Novotny (2011); Rayna (2012); Hassan and Ahmed (2012); Vincent, Laetitia and Frank (2014) conducted in USA, East Asian, Europe, Portugal and Nigeria document evidences in support of the postulation that the higher the ownership concentration the higher the conflict, other studies of Alves (2012); Usman and Yero (2012) disagreed with the premise. Although many of these studies uses data from developed

economies. The mix findings from these prior studies necessitate further studies using additional variable such as free cash flow to bring out clearer and better result. Another important issue to address is a domain gap because most of the studies are conducted in manufacturing firms, foods and beverages, conglomerate with a few studies in DMBs.

Conversely, this study established period gap in the work of Gebhardt and Novotny (2011) and Hassan and Ahmed (2012) conducted in Nigeria. The study used data for the period ended in 2011 while the revised code of corporate governance was introduced in (2009) in Nigeria banking sector, therefore the need to hypothesize the foreign ownership in relation to earnings management cannot be over-emphasized because, the impact of revised corporate governance cannot be ascertained considering the period used in their studies and the period the reversed code of corporate governance was re-introduced.

This study attempts to extend literature to address the gaps established in prior studies. Thus, the researcher hopes to provide answers to the questions that form the basis of this research. In this context, what is the effect of ownership structure on the earnings management and the moderating effect of free cash flow on the relationship between ownership structure and earnings management?

1.3 Research Questions

The study attempts to determine the moderating role of free cash flow on the relationship between ownership structure and earnings management. Specifically, the questions are structured as follows:

- i. Does executive director ownership affect earnings management of listed DMBs in Nigeria?
- ii. Does non – executive director ownership affect earnings management of listed DMBs in Nigeria?

- iii. Does institutional ownership affect earnings management of listed DMBs in Nigeria?
- iv. Does foreign ownership affect earnings management of listed DMBs in Nigeria?
- v. Does ownership concentrations affect earnings management of listed DMBs in Nigeria?
- vi. Does free cash flow affect earnings management of listed DMBs in Nigeria?
- vii. Does free cash flow moderate the relationship between ownership structure and earnings management of listed DMBs in Nigeria?

1.4 Objectives of the Study

The main objective of the study is to assess the effect of ownership structure on earnings management and the moderating role of free cash flow on the relationship between ownership structure and earnings management of listed DMBs in Nigeria. The specific research objectives are to:

- i. Examine the effect of executive director ownership on the earnings management of listed DMBs in Nigeria.
- ii. Investigate the effect of non-executive director ownership on the earnings management of listed DMBs in Nigeria.
- iii. Evaluate the effect of institutional ownership on the earnings management of listed DMBs in Nigeria.
- iv. Assess the effect of foreign ownership on the earnings management of listed DMBs in Nigeria.
- v. Examine the effect of ownership concentration on the earnings management of listed DMBs in Nigeria.
- vi. Investigate the effect of free cash flow on the earnings management of listed DMBs in Nigeria.

- vii. Determine the moderating effect of free cash flow on the relationship between ownership structure and earnings management of listed DMBs in Nigeria.

1.5 Statement of Hypotheses

- H₀₁: Executive director ownership has no significant effect on the earnings management of listed DMBs in Nigeria.
- H₀₂: Non - executive director ownership has no significant effect on the earnings management of listed DMBs in Nigeria.
- H₀₃: Institutional ownership has no significant effect on the earnings management of listed DMBs in Nigeria.
- H₀₄: Foreign ownership has no significant effect on the earnings management of listed DMBs in Nigeria.
- H₀₅: Ownership concentration has no significant effect on the earnings management of listed DMBs in Nigeria.
- H₀₆: Free cash flow has no significant effect on the earnings management of listed DMBs in Nigeria.
- H₀₇: Free cash flow has no significant moderating effect on the relationship between executive director ownership and earnings management of listed DMBs in Nigeria.
- H₀₈: Free cash flow has no significant moderating effect on the relationship between non-executive director ownership and earnings management of listed DMBs in Nigeria.
- H₀₉: Free cash flow has no significant moderating effect on the relationship between Institutional ownership and earnings management of listed DMBs in Nigeria.

1.6 Scope of the Study

The study covers the fourteen DMBs listed on the Nigerian Stock Exchange (NSE) as at 31st December, 2016 (NSE official daily listing, 2016). This constitute the population and

sample of the study. However, the variables cover in this study are executive director ownership, non- executive director ownership, institutional ownership, foreign ownership, ownership concentration, and free cash flow as a moderating variable. Only the executive director ownership, non- executive director ownership and institutional ownership variables are used in the moderation.

The foreign ownership and ownership concentration variable are not considered in the moderation because of multicollinearity problem. The choice of these variables is predicated on the code of corporate governance presumption that the variables are capable of curbing earnings management. The time frame for the study is 2007 to 2016. This period is considered relevant to the study because of the major reforms that took place in the banking industry in 2005, in addition to re-introduction of reversed prudential guideline in 2009 which now affects the provisions for loan losses in the banking industry. The financial crises which hit the banking industry between 2007 and 2009 is also fundamental and critical to the performance of banks thus the period is vital for this study. The data obtain from the period 2007 to 2016 is sufficient enough to provide valid findings. The discretionary loan loss provision is used as a proxy for earnings management.

1.7 Significance of the Study

The findings of this study will be beneficial to the banks, regulators such as Central Bank of Nigeria (CBN) Security and Exchange Commission (SEC), policy makers, Nigeria Stock Exchange (NSE), shareholders, potential investors, contractors to the banks, and management among others. The findings from the study will be important in strengthening the regulatory policy regarding earnings management which is vital to the CBN and SEC. This is because the recommendations from this findings will assist in improving the workability of ownership structure regarding monitoring mechanism to reduce earnings

management. If earnings management is reduced, the issue of manipulating earnings in the financial statements will be eroded.

Also, the empirical evidence from this work will aid regulators and policy makers, such as CBN and SEC in designing and implementing best governance policies regarding ownership structure that effectively monitor and discipline managers in the banking industry. Existing and Potential shareholders of the firms will benefit from the findings of this study. Because if the suggested recommendations in this study is implemented, the earnings manipulation by management will be minimised, shareholders wealth maximization objectives will improve through dividend payments and share prices.

The findings from this study will assist financial analyst in evaluating accounting information and advise the potential investors on the performances of the banks. This helps potential investors in making good decision as relate to investment. Similarly, the results of this study will be beneficial to the potential investors, because it provides insight into the role of ownership structure in congregating the interest of managers and shareholders. Since capital markets use accounting information to set share prices, the evidence from this work will raise the trust and confidence of both existing investors and potential investors regarding the integrity of the financial information which will refrain them from taking wrong investment decision.

In other hand, the findings will also be beneficial theoretically to students, researchers, academicians, corporate stakeholders in various ways. The theoretical contribution of this findings will assist the students, researchers, academicians to have a better understanding of the interaction between free cash flow and ownership structure in relation to earnings manipulation.

The study contributes to the conceptual issues on earnings management, how it is view in different studies and the definition given by this study. It also extend the body of

knowledge by its intensive explanation of different critiques of the accrual models and the detail clarification of the aggregate accruals use in firms other than banking industry and the specific accruals use in the banking and insurance industries.

The study also tests the ownership structure variables such as executive director ownership, non- executive director ownership, institutional ownership, foreign ownership, ownership concentration, free cash flow and the moderating role. The findings of this study contribute to the body of knowledge by establishing a significant positive relationship between executive director ownership and earnings management in deposit money banks in Nigeria as against the inverse relationship expected in the case of manufacturing and other non – financial institutions.

Similarly, this study provides the first evidence of the interaction between executive director ownership and free cash flow on the earnings management. The prior studies only focus on the specific accruals which is discretionary loan loss provision in the banking industry as the major factor influencing earnings management. But this study has provided further evidence that free cash flow reduces the ability of the manager to manipulate earnings if the funds available after financing viable projects is properly utilized or paid out to the shareholders in form of dividends.

The study also contribute to the body of knowledge by providing further evidence to validate the agency theory and code of corporate governance which encourage non- executive directors to have more holding to mitigate against the activities of managers vis – a vis earnings management.

The findings of this study offers an insight to the controversy of mixed findings on the relationship between institutional ownership and earnings management. Because, it helps the existing literature to explain the relationship between institutional ownership and earnings management. In the existing literature, the relationship between institutional ownership and

earnings management can be either ways that is the relationship may be positive or negative it depends on whether the institutional ownership is long term or short term.

The study is one of the few works that have contributed to the body of literature on the relationship between foreign ownership and earnings management in the DMBs of emerging market like Nigeria. A few studies in Nigeria focus on the relationship between foreign ownership and earnings management in manufacturing firms with limited studies in the area of DMBs. This may be as a result of paucity of data on foreign ownership in Nigeria. However, with the reverse code of corporate governance (2006) in the bank, this data is now available and adequate for studies.

Also, the study extend the body of knowledge on the relationship between ownership concentration and earnings management. The existing literature in Nigeria focus more on the manufacturing firms, food and beverages and others with limited literature in the area of banking industry in Nigeria. There are literature on ownership concentration but most of this literature are in developed economies and not emerging economy like Nigeria.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter discusses the conceptual issues relating to the study, reviews of empirical literature that relate ownership structure to earnings management, free cash flow and its moderating role. The chapter also discuss the two theories that underpin the study. The theories are agency theory and free cash flow theory.

2.2 Concept of Earnings Management

Earnings management has no single consensus definition widely accepted by all. Different scholars view earnings management in different forms. Healy and Wahlen (1999) define earnings management as what happened when managers use judgement in financial reporting and in structuring transactions to change financial information to either mislead some stakeholders about the underlying economic performance of the firm or to influence the contractual outcomes that depend on reported accounting numbers. They further argue that managers exercise judgement in different ways. For example, judgement is require to estimate different future economic events that are reflected in the accounting information such as expected lives and salvage values of long term assets, obligations for pension benefits and post-employment benefits, deferred taxes and losses from bad debts and assets impairments.

Accordingly, Carlosand Yun (2008) view earnings management as a range of purposeful interventions in the external financial reporting process, from legitimate activities to the violation of GAAP with the intention of misleading some stakeholders about the underlying economic performance of the firm. Earnings management does not only involve accounting technique, it also involve non accounting technique within GAAP. However, the definition recognises the intention of the manager to mislead the stakeholders. Although, the definition failed to bring in the rationale behind the earnings management practice to mislead

the stakeholders. According to Healy and Wahlen (1999), managers must choose among acceptable accounting methods for reporting the same economic transactions such as straight line or reducing balance method or the LIFO, FIFO or weighted average inventory cost method. From the above definition, it only focused on how earnings management is accomplished but does not exhaustively state the reason why earnings management exist. It is therefore important to note that managers try to influence the reported earnings for selfish interest but carry out the act within the purview of the General Accepted Accounting Principle (GAAP). The motive includes capital motivation, regulatory motivation, contracting motivation and compensation motivation.

Jiraporn, Miller, Yoon and Kim (2008) observe that public perceptions towards earnings management is that managers utilize earnings management opportunistically for their private gains rather than for the benefit of the stakeholders. The definition is based on public perception but not on empirical evidence, therefore, it might not present the true picture of the reason why managers engage in earnings management. In the same vain, Bello as cited in Zubair (2014) define earnings management as an attempt to cook / doctor or tailor financial accounting reports to a given desire outcome. The definition lacks substance as it fails to explain the reason for earnings management and the consequences of the managers' actions on the stakeholders. Zubair (2014) further regarded earnings management as ethical misconduct of accountants and relates it to the recent times corporate failures and loss of investors' confidence. However, the explanation of earnings management is given from the emotional perspective because it fails to explain further that if the accounts are prepared within the purview of the GAAP, managers have not committed any crime. The definition failed to give the direction to which earnings are managed. Jiraporn et' al (2008) argue that firms that are more informational opaque may engage in more earnings management because

a higher degree of asymmetric information makes it more difficult for shareholders to monitor the activities of the managers.

According to Al-Zyoud (2012), earnings management occurs when managers intentionally intervene in the financial reporting process to manipulate the reporting accounting numbers with the intent to mislead the stakeholders about the underlying economic position of the firm or influence contractual outcomes that depend on reporting accounting numbers to obtain personal gain or specific interest at the detriment of the shareholders. The focal point of this definition is that earnings management is an attempt to mislead stakeholders about the underlying economic performance of the firm. This occurs if managers have access to information and the process that is not made available to the outsiders, it gives room for information asymmetry and encourages opportunistic accounting. The definition fulfills the reason why earnings management exist, how is it accomplished and the direction to which earnings are managed. This study agrees with the definition of earnings management given by Al-Zyoud (2012) but the consequence of account manipulation is not only at the detriment of the shareholders alone but stakeholders. According to Habib, Uddin and Islam (2013), earnings management is the process by which management of a firm resort in the use of accounting choices that increase firm' income to conceal their poor performance. The definition only consider how earnings management is accomplished.

Likewise, Gajevsky (2014) view earnings management as manipulation of accounting figures or an outcome of ordinary operational practices appear to arise from the management motivation to mislead shareholders to ensure that the organization financial target have been met. The information asymmetry between the insiders and outsiders makes the individuals in the firm to rely on their control in financial reporting and the access to financial information within the firm to overstate the income or mask obtaining unfavourable results. The definition narrows the motivation for earnings management to financial benefit

motive. Conversely, Adzis, Anuar and Hislamudeen (2015) view earnings management as the manipulation of accrual items in the income statement to smooth the organizational earnings. The definition fails to explain the consequences of the managers' actions on the stakeholders.

The study of Kanagaretnam, Lobo and Yang (2000) assert that the earnings management incentives exist if bank's current performance as compare to the other banks is very high or very low. The implicit assumption underlying this premise is that regulators pay particular attention to banks with unusually high or low earnings. Earnings management do not occur only because of the regulatory cost. There are other incentives why earnings management occurs. Earnings management suggests that LLPs are intentionally understated to avoid the adverse effects of other factors on earnings in case of average performance. It implies that the manipulation of reported earnings aims at concealing a bank's real economic activities from disclosing the exact position of its riskiness for investors, regulators, and supervisors. Some scholars argue that earnings management mask the true financial result and business position to obscure facts and figures that stakeholders ought to know (Al-zyoud, 2012).

From the various views of the prior researchers, the study defines earnings management by elaborating the definition given by Al-Zyoud (2012). Earnings management occurs when managers intentionally distort the financial reporting process to manipulate the reporting accounting numbers or provisions of GAAP and prudential guidelines provided for specific accruals with the intent to mislead the stakeholders about the underlying economic position of the firm.

2.3 Motivation for Earnings Management

According to Graham, Harvey and Rajgopal (2005), manager's motivating factors to manage earnings are for reputation and career pursuit. Employee bonus is not among the key motivating factor. They further mentioned that managers are not willing to admit that, they manage their earnings to get a larger compensation. Earnings management thus offers personal risk hedging due to compensation option for the management. In addition to the personal motivation of the management, firms have other aspects that encourage earnings management. Managers default income for more efficient communication to improve the informativeness of the earnings and to also attract investors. According to Healy and wahlen (1999), the widespread use of accounting information by investors and financial analysts to help value stocks can create an incentive for manager to manipulate earnings in in an attempt to influence short-term stock price performance. Finally, management smooth their reported earnings for negotiation purpose. They manage earnings to convince their customers or suppliers that their incomes are stable. Management manipulate earnings to avoid apparent contract violations (Healy and Wahlen 1999). The external contracts include debt agreements, dividend contracts, supplies contacts and others. As accounting information used in foreign contracts, managers can alter the accounting data by managing earnings to meet up with the requirements. A firm may be required to maintain a specified minimum level of debt to equity, interest coverage or working capital. If such covenant is violated, the penalty may require higher interest rate, restriction on additional borrowing or immediate demand for repayment of the debt.

Many managers' performances are tag to the profit scale, so compensation management drive can motivate managers to engage in earnings management. It is important to note that many managers engage in earnings management to avoid regulatory violation and to minimise the political costs. Lastly, capital market motivation have been recognized as the

principal reason for a manager to manage earnings. According to Rahman, Moniruzzaman and Sherif (2013), motives for engaging in earnings management includes, Signaling or concealing private information, political costs, personal incentive and internal motive. Others are management compensation, contract motivation, lending and regulatory motivation.

In signalling or concealing private motivation motive, some firms engage in earnings management by altering their annual accounts to conceal their financial struggle without immediately measuring the consequences on stock price or Chief Executive Officer (CEO) compensation. The growth signal combined with another signal such as a stock split might be an effective way of communicating private information while political cost motivation involve altering financial statements to influence shareholders' opinions and decisions. Governmental regulations and tax laws may also serve as motivation for managers to engage in earnings management for tax avoidance and escape from government interference as higher earnings create room for such interference. Also personal incentives and internal motives are incentives other than financial motives for the CEO to manage earnings. A new CEO can be tending to downwards earnings management in the year of change and upwards earnings management in the following years. Retiring CEOs use upwards earnings management to leave in style and keep a seat on the board.

Internal motive are motives for earnings management that are not linked to external stakeholders (such as shareholders, government or unions) but are intra- firm. Within a firm, it might also be useful to alter financial reports or to structure transactions in such a way that budget ratcheting is avoided or performance standards are met. Managers will choose to use income-decreasing unexpected accruals when the earnings innovations are transitory. Firms using externally determined standards (i.e. relatively unaffected by participants such as peer group standards, fixed standards or cost of capital) are less likely to smooth earnings than those companies that use internal standards (budget goals,

prior year, subjective standards) and management compensation contract motivation is also known as the bonus plan hypothesis contends that managers are motivated to use earnings management to improve their compensation as management bonuses are often tied to the firm's earnings. It is thus expected that earnings management is used to increase income. Managers are more likely to report accruals that defer income when the cap on bonus awards were reached, as they had no more to gain from extra earnings and would be better off increasing income for the following year at that point. These ties in with the 'big bath' hypothesis, which suggests that if managers are unable to manipulate earnings to reach a particular target, they will have the incentive to use earnings management to decrease current earnings in favour of future earnings and, therefore, future bonuses.

Finally, lending contract motivation and regulatory motivation are other reasons why firms manage earnings. It is based on the fact that creditors often impose restrictions on the payment of dividends, share buybacks and the issuing of additional debt in terms of reported accounting figures and ratios, in order to ensure the repayment of the firm's borrowings. Hence, the assumption is that firms who have a lot of debt have an incentive to manage earnings to avoid breaching their debt covenants while regulatory motive takes place particularly in the banking, insurance and utility industries which are monitored for compliance with regulations which is linked to accounting figures and ratios. Banks and insurance firms especially are often subject to requirements that they have enough capital or assets to meet their liabilities. Such regulations may give managers incentives to use earnings management.

2.4 Measurement of Accruals-Based Earnings Management

Accounting accruals are considered as the most preferred means for management to manipulate earnings. Therefore, researchers have proposed three alternative approaches to

investigate the existence of accruals earnings management (Idris, 2012). These approaches are the aggregate accruals approach, specific accrual approach and distribution approach.

(a) Aggregate Accruals Approach

The aggregate accrual approach requires the aggregation of the net effect of numerous recognition and measurement decisions into a single measure. This method makes this approach more interesting because, in reality, managers are more likely to use several accruals rather than a single accrual to manipulate earnings (Jones, 1991). Consistent with this view, researchers have implemented this method in a wide range of contexts and have provided empirical evidences in support of the existence of accruals earnings management.

The six models under the aggregate accrual models are:

(b) Healy Model

Healy model is on compensation theory which is concerned with effect of earnings - based bonus contracts on managers' incentives towards managing earnings upwards or downwards. The model classifies bonus contracts according to earnings-based bounds into lower bond and upper bound. In the lower bound, bonus will be awarded to the managers if earnings exceed a lower bound of target earnings while in the upper bound, bonuses will be awarded to the managers if earnings exceed an upper bound of target earnings.

Using a sample of 94 firms with 1,527 firms -year observations which the model assigns each observation to one of three portfolios created according to a partitioning variable (i.e. earnings- based managerial bonus bound) where he hypothesised the direction of managerial manipulation into polio LOW, polio MID and polio UPP. Portfolio LOW are the observations for which bonus contract lower bound is binding while polio MID is where the neither lower bound nor upper bond is binding and polio UPP is where observations for which bonus contract upper limit is binding. In the scenario of portfolio LOW, he predicts that managers have the incentive to manipulate income by decreasing discretionary

accruals that is negative total accruals, because pre-managed earnings do not exceed the lower bound even if the maximum income - increasing choices were adopted. In the portfolio UPP scenario, he predicts that the managers have incentive to select income- decreasing discretionary accruals (i.e. negative total accruals), because the pre-managed earnings have exceeded the upper bound and any income-increasing choices will not be rewarded. While he predicts that the managers have incentive to select income increasing discretionary accrual that is positive total accrual. As a result, Healy's model confirms the compensation theory as the results of his tests, which show significant differences between means total accruals, indicate that these results are consistent with the hypotheses.

The approach suffers major criticisms which include the total accruals proxy for discretionary accruals in which Healy considers negative accruals as downward manipulation which could result from lower earnings or extremely high cash flow (Idris 2012). In addition, total accruals normally contain material negative non-discretionary accruals such as depreciation expense. This shows that even in the absence of earnings management, total accruals will contain major negative accruals which is non - discretionary. Therefore, a negative sign of total accruals does not necessarily signify managerial manipulation as assumed by Healy.

(c) De Angelo Model

De Angelo model attempts to fill the gap in underlying Healy's model by developing a non-zero benchmark for non- discretionary accruals. The model splits total accruals into non-discretionary and discretionary accruals, and then assumes that the non-discretionary component of total accruals is approximately constant over a period of time. The non - discretionary accruals in the event period (t) equal those in estimation period (t-1) which results in the change in non-discretionary component of accruals equal to zero ($ND \approx 0$). The model also assume that earnings manipulation is absent in the estimation period (DA

estimation= 0). Accordingly, for the estimation period, total accruals are all considered as non-discretionary ($TA_{t-1} = NAt-1$). This model fails to incorporate the effect of growth factor on non-discretionary accruals, the critique on Healy's model is therefore not overcome. De Angelo attributes the change in total accruals to managerial discretion whereas this change could be due to the effect of growth on firms operations which cause non-discretionary accruals to fluctuate over time. In this case, the result of the change in non-discretionary accruals would not equal zero.

(d) Jones Model

The model stepped down the assumptions in Healy's and De Angelo's models of being non-discretionary accruals constant over time and changes in total accruals due to managerial discretion. The critiques suggest that changes in total accruals might result from changes in underlying economic conditions as well. However, in contrary to the Healy and De Angelo models, Jones model attempts to isolate the non-discretionary component of accruals after controlling for changes in firms' economic environment.

Accordingly, Jones (1991) introduces revenues and property, plant and equipment in her regression model. Revenues are used to control for changes in working capital accruals while property, plant and equipment are used to control for non-discretionary depreciation expense, both before managers' manipulations. The stimulus of earnings management identified by Jones (1991) indicates that managers do not manage earnings before the period of interest ($DA_{est.} = 0$). This leads to the assumption that total accruals in the estimation period are all non-discretionary. The Jones model is considered as a milestone in the field of earnings management because it is the first model that separates observed accruals into their non-discretionary and discretionary components. Since then, several alternative models have been suggested by other authors to produce better discretionary accruals estimates (Idris, 2012).

(e) Modified Jones Model

Dechow, Sloan and Sweeney (1995) argue that the implicit assumption underlying Jones model that all revenues are non - discretionary causes the omission on the part of the managed earnings from the discretionary accruals proxy. Therefore, the modification introduced by the modified Jones model is the adjustment of revenues by net receivables in the event period, in which the authors expect earnings to be managed through discretionary revenues. Dechow *et al.* (1995) follow the first stage of the Jones model in which revenues are used to control for working capital non - discretionary accruals and property, plant and equipment are used to control for the depreciation of non - discretionary accrual. This indicates that the modified Jones model corresponds to the Jones model regarding the assumption of no systematic earnings management in the estimation period.

(f) Kothari, Leone and Wasley Model

This model proposes a cross –sectional regression - based model that extends the modified Jones model by several modifications. It includes an intercept because the first term in the Jones model is the reciprocal of lagged assets and hence, the Jones model does not have an intercept. The intercept serve as a deflator to reduce heteroscedasticity. They criticise the approach used by Dechow et al. (1995) in which the models' parameters are estimated from the first stage (i.e. pre-event period) in the Jones model are applied to a modified sales change variable defined as $(\Delta REV - \Delta REC)$. They argue that Dechow et al.'s (1995) approach is likely to generate large estimated discretionary accruals whenever a firm experience growth in the event period compared to the estimation period.

(g) Kang and Sivaramakrishnan Model

This model criticizes the Jones (1991) model that aggregate accruals models and decompose the total accruals into non-discretionary and discretionary accruals. In their critic, they observed that Jones model suffers from three limitation which include variable omission

and error in variables problem which arises from the variables used in the estimation of non - discretionary accruals, hence affected earnings management. This problem causes the measurement error to be correlated with the explanatory variables, leading to inconsistent parameter estimates and biased discretionary accruals proxy. The second limitation is the bias in testing earnings management if omitted variables, captured by measurement error, are correlated with PART. Finally, simultaneity problem arises because both the explained and explanatory variables are jointly determined by constraints imposed by double-entry bookkeeping.

(h) Specific Accruals Models

An alternative approach to that of aggregate accruals is to estimate the relation between a single accrual and explanatory factors. The prime benefit of specific accrual approach is that it allows the understanding of the behaviour of a certain account absent in earnings management based on the key factors of the generally accepted accounting principles. The specific accrual models are used in the banking and insurance industries. This models become more appealing in the research environment because the findings from the aggregate accrual models and distribution accrual models cannot be generalized in the banking and insurance industries. Several studies document the practice of earnings management through the specific accrual approach. For instance, Greenawalt and Sinkey (1988), Ma (1988), Ahmed (1999) provides evidence that financially weak banks tend to increase their income by manipulating loss reserves downwards. Another distinct research, conducted by Beneish 1997 as cited in Idris (2012) also documents earnings management by modelling for several specific accruals such as, receivables and inventory, separately. He confirms that GAAP violators were more likely to report positive accruals in years prior to, and including, the year of being identified as GAAP violators. Example of specific accrual model in the banking industry is Loan loss provisions model.

Loan Loss Provisions Measurement

The early literature of Greenawalt and Sinkey (1988) is focused mainly on detecting whether or not banks resort to earnings management and this generated a lot of debate in this area.

The following is the measurement for LLP used by Greenawalt and Sinkey (1988).

$$\frac{LLP_{it}}{TA_{it}} = a_0 + a_1 \frac{EBTP_{it}}{TA_{it}} + a_2 \frac{LG_{it}}{TA_{it}} + a_3 \frac{CO_{it}}{TA_{it}} + a_4 \frac{NPL_{it}}{TA_{it}} + a_5 \frac{CAR_{it}}{TA_{it}} + \frac{EBTP_{it-1}}{TA_{it}} + e_{it}$$

This measurement is used by other researchers in the existing literature. Example of other studies that used the measurement are Kanagaretnam, lobo and Yang (2004); Merve and Mustafa (2015); Onipe, Umar and Ahmed (2015). However, the work of Ahmed *et al.* (1999) modified the model by substituting tier 1 capital to the capital adequacy ratio and introduced change in loan loss to total assets in the measurement. The study provides a conflicting result on the earnings management, signaling but supporting the premise that bank use LLP to manage their capital. In the same vain, Anandarajan and Hassan (2005) modified the model as follow:

$$\log LLP = a_0 + a_1 \Delta LLA + a_2 \Delta GDP + a_3 MCAP + a_4 EBTP + e_{it} \quad (1)$$

$$LLPR = a_0 + a_1 \Delta LLA + a_2 \Delta GDP + a_3 MCAP + a_4 EBTP + e_{it} \quad (2)$$

In the measurement, the variables, earnings before tax and provisions and change in loan loss allowance is standardized by the total assets and log of total assets to control for firm size and other control variables included. In their study, they argue that, the change in loan loss variable included in the model was used in the study conducted by Ahmed et al (1999). The measurement for EBTP and MCAP was in agreement with the work of Greenawalt and sinkey (1988) but in testing for hypothesis on the use of LLP for signalling change in future earnings, Anandarajan and Hassan (2005) used the following model;

$$LLPR = a_0 + a_1 \Delta LLA + a_2 \Delta GDP + a_3 MCAP + a_4 \Delta EBTP + e_{it} \quad (2)$$

This measurement involve change in earnings before taxes and provisions $\Delta EBTP$ one year before instead of the one year ahead earnings before tax and provisions used in the study carried out by Greenawalt and sinkey (1988); Ma (1988); wahlen (1994) and Fernando and Ekanayake (2015). This result also contradicted the findings of the prior studies and it is inconsistent with the signal hypothesis. Also Wahlen (1994) conductes study and use the measurement below:

$$\frac{LLP_{it}}{TA_{it-1}} = LS_{it-1} + \alpha_{it-1} * \Delta NPL + \beta_{it-1} * NPL_{it-1} + y_{it-1} * LLA_{it-1} + e_{it}$$

The α, β and y are the parameters used for the measurements.

Similarly, Naila (2010) criticize the measurement use by Wahlen (1994) which fail to specify whether the smoothing is natural or artificial. In the amidst of mixed outcomes of the many US studies, the researcher come up with another measurement. This approach is available in two stages. Firstly, the author studies the variability of the object of smoothing so as to identify the group of smoothing banks. Secondly, the study determine whether earnings management is natural or intentional. To identify the artificial smoothing the study use the measurement below:

$$OL_{it} = aOL_i + bOL_i X_t + UOL_{it} \quad (1)$$

Where OL_{it} represent the net income of the bank i in the year t , X_t expresses the time variable at the year t and UOL_{it} represent residual between the published result and the estimated one. The second stage is to determine the discretionary Loan Loss Provisions using an equation which explicitly measure the non- discretionary portion of LLP (Wahlen, 1994; Beatty *et al.*, 1995; Kanagaretnam *et al.* (2004).

$$LLP_{it} = bi + b_2 \Delta NPL_{it} + b_3 \Delta Loan_{it} + LLA_{it-1} + ULLPU_{it} + e_{it}$$

According to Greenawalt and Sinkey (1988) and Wahlen (1994), ΔNPL_{it} , $\Delta LOAN_{it}$ and LLA_{it-1} can generally be considered as proxies for the bank credit risk and will be associated with a positive coefficient. The third stage consists in calculating each of Pearson's

correlation coefficient between the two residuals. A positive and significant correlation means that banks resort to artificial earnings management. Indeed, when the published result is superior to the objective one ($UOLit > 0$), the manager increases LLP ($ULLPit > 0$).

According to the work of McNichols and Wilson (1988) cited in Ahmed, Mohammed and Adisa (2014), there is a limitation in using the absolute value of loan loss provision when determining earnings management, they therefore provided a measurement for estimating residuals of bad debts regression model as a surrogate of discretionary accruals. This approach is known as the specific accruals method, which focuses on specific industries such as banks and insurance. The measurement is used to disentangle discretionary accrual from non – discretionary accrual. LLPs is define as the sum of the ending balance of allowance for bad and doubtful debts and loan charge-offs, then deducting the beginning balance of allowance for bad debts (Chang, Shen & Fang 2008). However, the beginning balance of total loan losses is included because it arises from past accumulations and serves as an inventory in setting the current loan loss allowance. This measurement consider two stages regression by running the first regression against explanatory variables and use the residual to run the second stage regression to determine the level of earnings management. The expression is as stated below:

$$LLP = f(LCO, BBAL) \quad (1)$$

$$\frac{LLP}{TA_{it-1}} = a_0 + \frac{1}{TA_{it}} + \frac{LCO_{it}}{TA_{it-1}} + \frac{LLA_{it-1}}{TA_{it-1}} + e_{it} \quad (2)$$

$$\frac{DLLP}{TA_{it-1}} = \frac{LLP}{TA_{it-1}} - [a_0 + \frac{1}{TA_{it}} + \frac{LCO_{it}}{TA_{it-1}} + e_{it}] \quad (3)$$

Beatty and leo as cited in Hansen (2015) performed factor analysis on nine discretionary LLP measurement and found three significant factors capture the nine measurement. They

constructed four measurement based on the factor analysis. The four models are;

- i. Aggarwal ,Liu and Ryan (2007) and Bushman and Williams (2012) used NPL, Firm size ie Log TA and macro - economic variables.
- ii. Whalen (1994), Beatty, Chamberlain and Magliolo (1995) and Collins, Shackelford and Whalen (1995) used lagged LLA ie LLA_{it-1}
- iii. Beaver and Angel (1996), Kim and Kross (1998); Roel (2011); Beck and Narayanmorthy (2013) used Net Charge – off

Beatty and leo as cited in Hansen (2015) tested the relevant factors in the model;

$$LLP_t = \alpha_0 + \alpha_1 \Delta NPL_{t+1} + \alpha_2 \Delta NPL_t + \alpha_3 \Delta NPL_{t-1} + \alpha_4 \Delta NPL_{t-2} + \alpha_5 \Delta NPL_{t-2} + \alpha_6 size_{t-1} + \alpha_7 \Delta GDP + \alpha_8 \Delta uE + \alpha_9 CSRE \quad (1)$$

$$LLP_t = \alpha_0 + \alpha_1 \Delta NPL_{t+1} + \alpha_2 \Delta NPL_t + \alpha_3 \Delta NPL_{t-1} + \alpha_4 \Delta NPL_{t-2} + \alpha_5 \Delta LOAN + \alpha_6 size_{t-1} + \alpha_7 \Delta GDP + \alpha_8 \Delta uE + \alpha_9 CSRE + \alpha_{10} LLA \quad (2)$$

$$LLP_t = \alpha_0 + \alpha_1 \Delta NPL_{t+1} + \alpha_2 \Delta NPL_t + \alpha_3 \Delta NPL_{t-1} + \alpha_4 \Delta NPL_{t-2} + \alpha_5 \Delta LOAN + \alpha_6 size_{t-1} + \alpha_7 \Delta GDP + \alpha_8 CSRE + \alpha_9 NCO + e \quad (3)$$

$$LLP_t = \alpha_0 + \alpha_1 \Delta NPL_{t+1} + \alpha_2 \Delta NPL_t + \alpha_3 \Delta NPL_{t-1} + \alpha_4 \Delta NPL_{t-2} + \alpha_5 \Delta LOAN + \alpha_6 size_{t-1} + \alpha_7 \Delta GDP + e \quad (4)$$

The studyscale the following variables by lagged total loans in order to mitigate heteroscedasticity:

LLP = Loan Loss Provisions

ΔNPA = Change in Non-Accrual Loans and Loans 90 days or more past due from the previous quarter.

$\Delta Loans$ = Change in total loans from the previous quarter.

LLA = Loan loss allowance at the beginning of the quarter.

NCO = Net Charge offs (total charge offs minus total recoveries)

The remaining variables are

SIZE = Natural log of total assets

Δ GDP = Percentage change in GDP over the quarter

CSRET= Return on the Case -Shiller Real Estate Index during the quarter

Δ UE = Percentage change in unemployment rate during the quarter

$$LLP_t = \alpha_0 + \alpha_1 \Delta NPL_{t+1} + \alpha_2 \Delta NPL_t + \alpha_3 \Delta NPL_{t-1} + \alpha_4 \Delta NPL_{t-2} + \alpha_5 \Delta LOAN + \alpha_6 \Delta size_{t-1} + \alpha_7 \Delta GDP + \alpha_8 \Delta UE + \alpha_9$$

$$CSRET + \alpha_{10} \Delta LLA_{t-i} + \alpha_{11} \Delta NCO_t + \alpha_{12} \Delta NPCC_t + \alpha_{13} \Delta NPRE + \alpha_{14} \Delta NPCOM + \alpha_{15} \Delta PIND + e_t \quad (5)$$

The additional loan type variables shown in this model are:

Δ NPCC = Change from the previous quarter in non-accrual credit card loans and credit card loans 90 days or more past due.

Δ NPRE = Change from the previous quarter in non- accrual real estate loans and real estate loans 90 days or more past due.

Δ NPCOM= Change from the previous quarter in non-accrual commercial loans and commercial loans 90 days or more past due.

Δ NPIND = Change from the previous quarter in non-accrual individual loans (other than credit card loans) and individual loans 90 days or more past due.

The purpose of all of the above models is to separate LLP into discretionary and non – discretionary components. The adjusted r-squared from each model is compared to determine which of the models does the best job of predicting LLP. The residual from each regression is the proxy for DLLP. Beatty and Leo as cited in Hansen (2015) conclude that change in non-performing loan, loan loss allowance, Net charge –off and change in loan are all significant for determination of discretionary Loan Loss Provisions. It is worthy to note that Ahmed et’ al. (1999) after using tier 1 capital for determining capital management later conclude that capital adequacy ratio is the best measure for capital management.

From the conceptual issues, it is observed that the measurement for determining discretionary Loan Loss Provisions in the existing literature have common ground on some of

the variables such as Change in Non – performing loan NPL, Charge – off, log of total assets, loan growth or loan size, loan to capital adequacy ratio. However, there are still controversies on the issue of how these variables are scaled. Some existing literature such as Greenawalt and sinkey (1988), Ma (1988) used the year end figures for the variable while the work of (Wahlen, 1994; Beatty *et al.*, 1995), McNichols and Wilson cited in Ahmed, Mohammed and Adisa (2014) consider the variables at the beginning of the year. Although apart from the work of Ahmed et al (1999) and Anandarajan and Hassan (2005) that provide a conflicting evidence, others' findings were consistent. However, the argument for scaling the variables using the beginning balance of total assets to avoid over- blowing or present of heteroscedasticity in the estimations and the proposed discretionary accruals for estimation using both the cross sectional variation of the Jones model (1991) and the cross sectional variation of the modified Jones model proposed by Dechow et' al (1995), that are commonly used by most of earnings management research used total assets at the beginning of the year.

(i) Distributional Approach

Studies within this approach investigate earnings management around certain benchmarks by examining the density of the distribution of firms' earnings after management. The basic assumption underlying this approach is that the distributions of unmanaged earnings or unmanaged changes in earnings are relatively smooth (Ronen & Yari, 2008). Yet, if firms have incentives to meet a certain benchmark, then the distribution of managed earnings will have fewer (more) observations than expected for earnings amounts just below (above) the threshold. Dichev and Skinner as cited in Idris 2012) find evidence that firms manage their earnings upwards to avoid the violation of debt covenants. Although, researchers raise several criticisms against this approach. Most prominently, Jacob and Jorgensen (2007) attribute the distribution with fewer observations that fall below the

threshold to the fact that firms may manage earnings downwards when they realise that they will not be able to meet the benchmark.

2.5 Concept of Ownership Structure

Ownership structure is one of the most important corporate governance mechanism to solve agency problems (Jensen & Mechling 1976). Ajagbe and Ismail (2014) define ownership structure as the distribution of equity with regard to votes and capital but also by the identity of the equity owners. Firms may be owned by a diverse mix of different types of investors. However, the investors may differ with respect to their trading styles, clientele, legal and regulatory environments, and their ability to gather and process information (Brain, Connelly, Tihanyi & Trevis, 2010). According to Mehrazeen and Mehrtash (2012), ownership structure aims at improving accountability, clarity and observance of beneficiaries' rights. The ownership structure could lead to control of managers' authority in their reporting. It moderates the activities of the managers in relation to corporate performance, dividend policy, income returns, management and corporate capital and agency costs, as well as earnings manipulations. Therefore, the introduction of ownership structure could lead to reduction in information asymmetry problems, increase shareholders trust as a result of reduction in earnings management and other sharps practices. Thus, ownership structure effectiveness is an important mechanism that can constrain earnings management as proxy for agency cost.

A firm ownership structure has two dimensions; ownership concentration and nature of the owner. Firms may differ from one another due to the ownership concentration or disperse. The nature of ownership also matters as two firms may differ if the government holds a (majority) of stake in one of them. The ownership structure is measured by the fraction of shares held by the insiders or by the largest shareholders or both. Insider holdings are used as a proxy for managerial share-holdings and include not only the management team

but the holdings of the board of directors. The separation of ownership from control affect the quality of governance in a corporate entities (Abdul & Idris, 2014). For the market of corporate control to work effectively, managerial teams must essentially compete to control specific corporate assets, but the ownership structure of firms that are supposed to serve as the disciplinarian in the market for corporate control also comes into play (Brain, Connelly, Tihanyi & Trevis 2010).

The relationship between manager and shareholder in the agency theory is described as relationship between agent and principal in which the firms' principals provide a trust towards agents to manage the firm in accordance with the interests of the principal which is associated with higher dividend expectations. Jensen and Meckling (1976) argue that managers act on behalf of the shareholders who are the actual owners of the firm. This relationship empowers the managers to control the resources of the shareholders and leaves the shareholders with no control over the decision making processes. The managers only report to the shareholders at the Annual General Meeting (AGM) on the performance of the firms. Therefore, managers are left with so many discretions on the activities of the firms with a minimal monitoring. It is therefore argue that ownership structure such as executive director ownership, non – executive director ownership, ownership concentration, institutional ownership and foreign ownership plays a vital role in the monitoring and quality of financial reporting.

2.5.1 Executive Director Ownership

The board of directors is a significant stakeholder in a firm because they have the power to direct the firm, (Institute of Chartered Accountant of Nigeria (ICAN), 2012). They act as agent to the shareholders and represent the interest of the firm. A board of director consist of executive director and non-executive director. The executive directors have executive responsibilities as managers of the firms in addition to their role as director. They

are usually full time employees of the firm. Non-executive directors are involve in the executive management and are on part time basis. Since the executive- directors combine their role as director with their full time job as firm employees, their interest are likely to differ from those of non – executive directors. The executive ownership is the percentage of shares owned by the executive director divided by the total share of the firm. On the board of directors, some individuals might have considerable more influence than others. The most influential members of the board are the firm chairman (board chairman) and the managing director often called Chief Executive Officer (CEO). Warfeild *et al.* as cited in Zubair (2014) lament that the convergence hypothesis state that insider will be seen as monitoring mechanism when they acquire some portion of the firm' equity, they will prevent managers opportunistic behaviour and the magnitude of discretionary accruals is predicated to be inversely associated with the insider ownership. All the executive directors have stake in DMBs but their interest are not substantial.

2.5.2 Non – Executive Director Ownership

Agency theory suggests that non – executive director may have an important monitoring function of financial reporting process (Alves, 2014). The non – executive director ownership is the percentage of the shares hold by the non - executive director divided by the total number of the shares in the firm. According to Alves (2014), boards of directors with more non-executive directors have tendencies for increasing the monitoring mechanism and they are expected to emphasis on better earnings management that improves the integrity of financial reporting. He further argues that boards of directors are the primary element of corporate governance, because they are responsible for monitoring the quality and integrity of financial information and also control top management as delegated by the shareholders.

However, Habbash, Salama and Dixon (2008) opine that non – executive directors are the shareholders' representatives and their responsibilities have direct impact on shareholders

'perceptions of the firm's financial reporting integrity and quality which in turn may constrain the inclination of managers to engage in earnings management. In another critical view, Fich and Shivdasani (2006) observe that one of the concerns raised in the activities of the non- executive directors is their tight schedule and other commitments which made them participate only on the part time basis in the affairs of the firms. Thus, this less involvement of the non – executive director resulting from tighten time schedule might reduce their ability to monitor the activities of the managers. In another argument, Alves (2014) states that the non- executive directors on the board provide supervision mechanism by mitigating managerial self-interest and controlling the production of financial information. According to Byrel and Hickman as cited in Alves (2014), shareholders of firms with non - executive directors serving on boards maximize the managerial behaviours and will distinguish between good and bad decisions. Some non- executive directors have stake while others do not have but the stakes of non- executive directors in DMBs are not substantial.

2.5.3 Institutional Ownership

Institutional ownership are always refer to as sophisticated investors that have the advantage of acquiring information compared to individual investors (Jiambalvo as cited in Ali *et al.* (2015). Ali *et al.* (2015) also state that the substantial shareholding in a firm gives the institutional investors resources and reasons for having incentives to monitor and influence the decisions made by managers. Therefore, a negative relationship between managerial ownership and earnings management is stronger in small firms than large firms because institutional investors play their monitoring role in large firms. According to Abdullahi as cited in Zureigat (2011), institutional ownership is an investment from a certain institution, and is usually higher than the investments of individuals.

Zureigat (2011) further argue that it is assumed that institutional investors have more influence than other individual investors. He observes that institutional ownership is an

important factor that could assist companies to perform effectively, he also find the companies tend to be audited by the Big 4 if the level of institutional ownership increases. Warfield, Wild, and Wild (1995) indicate that the higher the holding of institutional and block - holders, the smaller the discretionary accruals and the greater the informativeness of earning. Sharma as cited in Tsai and Liu (2015) find that as the percentage of independent institutional ownership increases, the likelihood of fraud decreases. They suggest that institutional ownership can play an active role in monitoring and disciplining managerial discretions and in controlling the reporting process. However, some studies argue that institutional investors do not play an active role in monitoring management activities (Claessens & Fan as cited in Kazemian & Senusi , 2015).

According to Duggal and Millar as cited in Kazemian and Senusi (2015), institutional investors are passive investors who are more likely to sell their holdings in poorly performing firms than to expend their resources in monitoring and improving their performance. Institutional investors may be incapable of exerting their monitoring role and vote against managers because it may affect their business relationships with the firm. Institutional ownership is the percentage of the share held by institutional investors divided by the total number of shares.

2.5.4 Foreign Ownership

Foreign investors play an important role in improving internal governance mechanism in an organization (Aggarwal, Erel, Ferreira & Matos 2011). Brennan and Cao (1997) and Dvorak as cited in Guo *et al.* (2015) find that foreign investors' trading performance is inferior to that of domestic investors, because of their information disadvantage. The information asymmetry hypothesis predicts that the distance makes it difficult for foreign investors to monitor a firm's accounting department and limit real earnings management, whereas the knowledge spill over hypothesis predicts that the superior knowledge of foreign

investors can curtail earnings management. Foreign investors can be seen as an effective mechanism that could complement the governance structure to monitor the management from non – value maximum activities because their role resemble that of institutional investor (Dahquest & Robertson as cited in Ali, Saleh & Hassan 2008).

According to Kho, Stulz, and Warnock (2009), foreign investors from a well - regulated countries are found to have an advantage when serving as monitors in poor governance countries. Specifically, foreign investors can promote the corporate governance of local firms through either direct monitoring by using their voting rights to influence managerial decisions or indirect monitoring by threatening to divest their investments in local firms (Aggarwal, Erel, Ferreira & Matos 2011). They can help local firms improve the oversight on the accounting process and increase the efficiency of operations by bringing in their wealth of experience in the application of International Financial Accounting standards and better management styles. Indeed, foreign institutional ownership is find to be significantly higher in those countries that adopt International Accounting Standards (IAS) Covrig, De Fond and Hung (2007). Foreign ownership is the percentage of shares holding by foreigners in relation to the total shareholding. All DMBs in Nigeria have foreign ownership but the foreign holding is substantial in GTB and Union Bank.

2.5.5 Ownership Concentration

Ownership concentration refers to 5% and above holdings by the shareholders in relation to the total share outstanding. Conceptually, concentrated ownership may improve performance by increasing monitoring and alleviating the free-rider problem in takeovers (Shleifer Andrei, and Robert 1986) but other mechanisms may work in the opposite direction. Traditional agency theory claims that more concentrated ownership would enhance the ability of shareholders to monitor management of the company by preventing it from taking self-serving decisions affecting the performance of the company negatively. This

claims may be true in market environments where laws and legislation protecting minority shareholders are strong. Concentrated ownership creates majority shareholders and minority shareholders with diverging interests and objectives. In a market environment where laws protecting minority shareholders are absent or weak, a situation of majority shareholders controlling the company will be created and the performance of the company would be affected negatively.

According to Earle and Kulsera (2004), most frequently discussed is the possibility that large shareholders exercise their control and rights to create private benefits, sometimes expropriating from smaller investors. Other block-holdings have coefficients that are statistically insignificant and usually negative. The sum of all block-holdings has effects that are estimated to be positive, but they are always statistically insignificant and much smaller in magnitude than that of the largest block-holder. A firm is said to be highly concentrated if a significant portion of its equity is in the hands of few individuals (Roodposhti & Chasmi as cited in Usman & Yero 2012). Few individuals with more stake have more reason to be worried about their investments and hence monitor the management of the firm's affairs. Helfin and Shaw (2000) as cited in Zureigat (2011) argue that monitoring by large shareholders may give them access to private and value relevant information. In companies with concentrated ownership, the large shareholders can influence management, especially when they become board members, and they have a lot beyond the board. All DMBs in Nigeria have concentrated ownership of 5% and above.

2.6 Free cash flow

Jensen (1986) defines free cash flow as the cash flow from operating activities in excess of funds that are needed for investment in projects with positive net present value (NPV) when discounted at the relevant cost of capital. Operating cash flow on cash flow statement indicate firm's ability to produce cash flow from its business activities. He opine

that projects should be measured regarding to net present value through applying a reliable cost of capital and if the result is positive, the necessary cash for the investment deduct from firm's available cash, whatever remains will be considered as free cash flow.

Raise and Vaiz (2016) report that the cash obtained from the operational activities not only should be invested in the new fixed properties in order for the company to maintain the current level of its operational activities, but also a portion of this cash should be distributed among the stakeholders as the share interest or its redemption in order to satisfy the stakeholders. Thus, the cash obtained from the operational activities cannot be solely perceived as the ability of the financial firm for creating the cash flow. Conversely, in the absence of good growth opportunities, an over- investment problem is likely to arise, which is detrimental to shareholders (minority ones, at least). This situation is explained by leaders' willingness to unavoidably promote firm's growth to increase its size and, de facto, their level of compensation (Jensen & Murphy, 1990).

Another critical issue that if the surplus cash available after profitable projects has been financed is distributed to the shareholders as dividends or super dividend, it reduces the conflict of interest between shareholders and managers. Jensen (1986) lays the prominence on the managers' misuse of these funds which allocation has nothing to do with the firm's interests. Indeed, in companies with good growth opportunities, agency costs related to the FCF problem are not significant enough Lasfer (2006); Gregory & Wang (2013). A FCF situation is also a motivation for a firm to repurchase its own shares as well as carry out related parties transactions (with leaders, major shareholders and directors), full-fledged means of extracting private benefits and expropriating of minority shareholders (Nekhili & Cherif, 2011). According to Richardson (2006), the free cash flow situation adversely affect the firm's financial position by lowering the stock prices and managers' replacement. To reduce its impact, the managers might manipulate earnings to conceal their use of available

discretionary funds and facilitate the extraction of private benefits of control (Leuz, Nanda & Wysocki 2003). According to Len and Poulsen as cited in Bhundia (2012) free cash flow is operating income before depreciation expense after tax, interest expense and preferred and common stockholders' dividends.

According to *Chunget al. (2005)*, the manager may engage in investing cash flow in the unprofitable project due to his or her selfish interest which might result in low growth. Therefore, in the absence of effective monitoring or disciplinary actions by other independent stakeholders, the manager can conceal information on the activities by providing minimal disclosure or manipulating accounting number. Investors as a group of stakeholders do not have access to inside information. Managers may not provide adequate and reliable information to the investors on the investment cash flow or the underlying assumptions of the project. Based on this minimal information, investors may not be able to know the prospect and the advantages or disadvantages of the project for their wealth. They also argue that managers may not provide the internally projected cash flow for some investments. As a result of personal interests, managers overlook the need for preparing projected cash flow and profit forecast. The choice for making poor investments may reduce future earnings and lead to a removal of directors or senior executives.

2.7 Review of Related Empirical Studies

Related empirical studies on the ownership structure and earnings management are also review hereunder.

2.7.1 Ownership structure and Earnings management

Ownership structure of a firm can be categorised into two groups, proportion of shares owned by insiders and outsiders (Dimitropoulos & Asteriou (2010). The debate as to whether or not the ownership structure effectiveness is an important mechanism to restrain managers from engaging in the earnings management activities is reviewed from five perspectives such

as executive director ownership, non – executive director ownership, institutional ownership, foreign ownership and ownership concentration.

The executive ownership is expected to provide monitoring mechanism to inhibit earnings management if the stake given to the executive directors are substantial otherwise, they will engage in account manipulation. Also, the executive directors can take the advantage of compensation plan by manipulating the accounting information for such benefit. Also, the non- executive directors who are not directly involve in the accounting process are likely to provide monitoring mechanism to inhibit earnings management. However, the effectiveness of executive director ownership in providing mechanism to inhibit earnings management depend on whether their stake are substantial or not, see the study of Musa & Nafiu (2017). Also, institutional ownership could be stable institutional ownership or unstable institutional ownership.

The stable institutional ownership are keeping their investment in the firm for a long term and therefore monitor the activities of earnings management while unstable institutional ownership sees monitoring mechanism as a waste of resources therefore failed to provide monitoring mechanism, see the studies of Vince, Mohammed & Oluwatoyin (2016); Hamid (2016); Alzoubi (2016).The study also discusses the evidences on how free cash flow relates to earnings management and the justification for the moderation role of free cash flows on the relationship between ownership structure and earnings management. The ownership concentration play an important role in the in the earnings manipulation. If the stake of a firm is concentration in the hand of few investors, there is tendency to manipulate the reported earnings for their selfish interest. The examples are the DMBs in Nigeria such as Oceanic bank and intercontinental banks which had the larger portion of their stakes in the hand of a few individual run into capital depletion problem while reporting profit. Therefore ownership concentration if not properly disperse lead to earnings management, see the studies of Huy

(2016);Francisco & Anna (2017). The foreign ownership is suggested to provide monitoring mechanism to inhibit earnings management in the studies of Guy (2015); Huy (2016); Alzoubi (2016).

2.7.2 Executive Director Ownership and Earnings Management

Agency theory postulate that the separation of ownership from control increases conflict of interest between the shareholders and the managers. This conflict of interest therefore increases the agency cost. In other to reduce the agency cost, the agency theory suggest that if more shares are given to the directors or insiders, the issue of agency cost will be drastically reduced, although not in all situation

Notwithstanding, the executive director and non- executive director might have divergence interest. The executive directors have direct access to the accounting process while the non- executive directors do not. It is on this bases that Vince et al (2017) assess the relationship between managerial ownership and earnings management using a sample of 115 manufacturing firms listed on the Indonesia stock exchange and find that managerial ownership have positive relationship with earnings management. Also, the study of Musa and Nafiu (2017) which examine the effect of ownership structure on earnings management using a sample of listed conglomerates in Nigeria for the period of 2004 to 2008 find a negative relationship between managerial ownership and earnings management. The study of Obigbemi (2017) provides a conflict result which reveal that managerial ownership has a negative relationship with earnings management.

In another study, Kazemian and Zuraida (2015) examine the effect of ownership structure on earnings management of find that managerial ownership is negatively related to the earnings management. Onoye and Eriki (2014) examine how corporate governance mechanism relates to earnings management using a sample of 130 firms listed on Nigeria

Stock Exchange for the period of 2005 to 2010 and find that board independent have a positive and significant influence on the profitability and board size and CEO shareholding have insignificant influence on the earnings management. Olayinka (2012) examines earnings management in relation to the corporate governance in Nigeria using a questionnaire survey and find that board dominated by outside director brings a greater breadth of experience to the firm and in better position to monitor and control managers thereby reducing earnings management.

Sanchez, Ballesta, Garsa and Meca as cited in Elijah and Isenmila 2012) examine the relationship between ownership structure and earnings management using discretionary accruals for a sample of Spanish Non-financial companies. The result supports the hypothesis that insider ownership constraining earnings management when the proportion of shares held by insiders is not too high. When insiders own a large percentage of shares, they are entrenched and the relation between insider ownership, discretionary accruals reverses.

However, Alves (2012) examines the relationship between corporate ownership structure in Portugal and earnings management which he reveals partly different results from Reyna (2012). The study analyses whether a firm's ownership structure (measured with three variables, managerial ownership, ownership concentration and institutional ownership) exacerbate or alleviate earnings management. Using a sample of 34 Euronext Lisbon non-financial firms over a period of 6 years, from 2007 to 2014 firm-year observations). The study finds that discretionary accruals as a proxy for earnings management is negatively related to both director ownership and ownership concentration. Specifically, the results of this study shows that both director ownership and ownership concentration inhibit earnings management. This result is consistent with both the alignment of interest hypothesis, which suggests that managers who own a significant portion of the equity in a firm have less incentive to manipulate reported accounting information, and the efficient monitoring

hypothesis, which suggests that large shareholders reduce the scope of managerial opportunism. Moreover, the results also reveal less earnings management when operating cash flow are high and more earnings management when political costs, leverage and board size are high. Finally, the findings highlight the importance of ownership structure, mainly managerial ownership and ownership concentration, in constraining the likelihood of earnings management in Portugal. Therefore, this study indicates that both director ownership and ownership concentration affect the informational quality of earnings positively, and consequently enhance the quality and value relevance of published financial data. It is observed that the study uses aggregate director ownership instead of executive director ownership variable and the period of 8 years is not sufficient enough to feel the effect of ownership structure on earnings management.

Nedal *et al.* (2010) evaluate the relationship between earnings management and ownership structure of Jordan firms for a period of 2001 to 2005. The study uses executive director ownership, institutional ownership and block - holder ownership as independent variables using generalized method of moment (GMM). The findings reveal a significant and positive relationship between ownership structure and earnings management. Further analysis shows an insignificant relationship between institutional ownership, block-holder ownership and earnings management. However, the study left out foreign ownership in its independent variable. Also, Nedal *et al.* (2010) examine ownership structure and earnings management of Jordanian industrial sample firms. The sample uses in this study comprises the 39 listed industrial firms' analysis, which represents around 64% of Jordanian Industrial firms listed on Amman stock exchange between 2001 and 2005. In this study earnings management is measured by discretionary accruals. The three types of ownership studied are; director, institutions and block-holders ownership. This study used the Generalized Method of Moment (GMM) and find a negative relationship. However, the findings of this study

could not be generalized in the banking industry because of discrepancies in the measurement. Koh (2003) investigates Australian firms in relation to the relationship between director ownership and aggressive earnings management practice and find a positive association between them. This result is consistent with the view that high directors' ownership encourage managerial accruals discretion

The findings from the studies are mixed. This might be due to different domain, regulatory and legal environment. Most of the studies focus on director ownership without splitting them into executive and non- executive. However, the executive director and non – executive director might not behave the same, therefore, there is need to investigate further the relationship between executive director ownership and earnings management.

2.7.3 Non – Executive Director Ownership and Earnings Management

The concern as to whether or not the presence of the non- executive directors on the boards of the firms mitigate the activities of the managers in relation to the earnings management generate a serious debate in the academic literature. Because the workability of non- executive director ownership depend on whether the shares are substantial or not. In Nigeria, the average holding of the non- executive directors in DMBs is 2.7%. However, .Yohan (2017) assess the effect of outside directors quality on firms value and earnings management using a Korean listed firms for the period of 2000 to 2012 and find that the non – executive director ownership has negative effect on the earnings management while the study of Raheal (2017) reveal a contradictory evidence that board independence has positive relationship with earnings management.

Also, the study of Huy (2016) investigates the extent of whether board of directors and ownership characteristics are related to earnings management for a period of 2010 to 2014 and find that non- executive director ownership do not inhibit earnings management. On

the contrary, the study of Mohammed Khalil & Aydin Ozkan (2016) examine the relationship between board independence and earnings management. The study reveal that non-executive director has negative and significant relationship with earnings management. The result therefore confirm that non-executive director ownership provides monitoring mechanism to inhibit earnings management

Also, another study conducts by Dimitropoulos and Asteriou (2010) examine the impact of board independence on earnings management for 97 non-financial firms listed on the Athens Stock Exchange in Greece for the years 2000 - 2004. Consistent with Anglo-American countries' studies, they find that non – executive director is significantly and negatively related to earnings management. The two studies are conducted in the non-financial institution which corporate governance is completely different from that of DMBs in Nigeria. Also, the Anglo – American countries business environment is completely different from that of emerging market. Osma (2008) tests whether board composition is effective in constraining earnings manipulation in a sample of Spanish quoted firms during the period 1999–2001 for a sample of 155 firm-year observations. Their findings reveal that, in Spain, the key practice to constrain earnings management is the appointment of institutional directors, but non - executive director do not play a significant role. Abdul Rahman and Ali (2006) investigate the effectiveness of board independence in constraining earnings management behaviour taken a sample of 97 Malaysian listed firms over the period of 2002 to 2003 and reveals that earnings management is positively related to the size of the board of directors but finds an insignificant relationship between either board independence or audit committee independence and earnings management. Siregar and Utama (2008) examine the effect of ownership structure, firm size and corporate governance practices on earnings using a sample of 144 Indonesian firms listed on the Jakarta Stock Exchange for the

period of 1995 -1996 and 1999 - 2002. The result do not find evidence that firms with independent boards engage in informative earnings management.

The findings from the prior studies shows contradictory findings. Some of the studies reported positive relationship, while some reported inverse relationship and others are inconclusive. The need to subject the non- executive director and earnings management for further test cannot be over emphasized as the review has shown the dearth of research in this area of interest.

2.7.4 Institutional Ownership and Earnings Management

Agency theory suggests that monitoring by institutional ownership can be an important governance mechanism that is, (efficient monitoring hypothesis). In fact, institutional investors can provide active monitoring mechanism that is difficult for smaller, more passive or less-informed investors. To confirm this supposition by agency theory, Raheel (2017) assess the effect of institutional ownership and earnings management of the firms listed on the Pakistan stock exchange for the period 2008 to 2014 and find that institutional ownership is positively related to earnings management.

Also, Hamid (2016) examines the effect of stable institutional ownership on earnings management and find that long term institutional ownership reduces earnings management. Adebisi and Olowookere (2016) study ownership structure and quality of financial reporting using data from DMBs in Nigeria for a period of 2005 to 2013 and find that institutional ownership has a negative relationship with quality of financial reporting. In another study, Kargo, Nordin and Turmin (2015) examine the influence of institutional ownership on earnings management in Malaysia using modified Jones model and find that institutional ownership constrain real earnings management. Alzoubi (2015) also assess the relationship between ownership structure and earnings management in Jordan measuring the magnitude of

discretionary accruals as proxy for earnings management using cross-sectional modified Jones model on a sample of 62 companies listed on the Amman stock exchange and find that institutional ownership, external block-holders and foreign ownership have superior influence on financial reporting quality and to an extent curtail earnings management. It also reveals that the aspect of ownership structure has a significant influence on earnings management.

In furtherance to the prior studies in Nigeria, Baba (2015) examines the effect of institutional ownership on earnings management in the insurance industry using the listed insurance firms on the Nigeria Stock Exchange for the period of 2008 to 2013 and reveals an inverse relationship between institutional ownership and earnings management. This finding is in confirmation of the prior studies which reveal that given out more stake to the external holdings constrain the negative tendency of the managers in manipulating reported earnings. This result contradicts the findings of Hsu (2014). The findings from the work done in Taiwan and that of Nigeria on the relationship between institutional ownership and earnings management produce mixed findings. This may be as a result of different measurement, business and regulatory environment. Therefore, there is need for further investigation on this variable. The institutional investors have the opportunity, resources, and ability to monitor the activities of the managers against earnings management. Therefore, the efficient monitoring hypothesis suggests that institutional ownership is associated with a better monitoring of management activities and reducing the ability of managers to opportunistically manipulate earnings (Senusi & Kazemain, 2015). The hypothesis also suggests an inverse relationship between a firm's earnings management activity and its institutional share ownership. Hsu (2014) studies the relationship between institutional ownership and earnings management and reports an inverse relationship between earnings management and institutional ownership for Taiwanese firms.

In the same vein, Sayim and Suleyman (2014) investigate the impact of corporate ownership structure and board size on earnings management using a sample of Turkish firms registered on the Istanbul Stock Exchange (ISE) for the period of 2009 to 2012 and apply adjusted Jones Model and the multivariate regression technique. The study reports that the institutional ownership and the board size have a negative significant effect on the earnings management while the effect of the managerial ownership on the earnings management is positive and significant. The findings also reveal that the return on assets has a positive and significant effect on earnings management. However, the impact of the financial leverage on earnings management is negatively and statistically significant. The result is consistent with the findings of Cheng & Reitenga (2009). They predict that the active institutional block holders utilize their controlling ability only when earning pressure is strong. Al-Abbas (2009) also documents a statistically significantly relation between earnings management and institutional ownership of the firms listed on the Saudi Arabian Stock Market.

Similarly, Mehmet, Suleyman and Mustafa (2014) investigate the impact of corporate ownership structure, board size and earnings management of firms listed on the Istanbul stock exchange for the period of 2009 to 2012. The study reveal a negative relationship between institutional ownership and earnings management. This confirm the assumption that long term institutional ownership provides monitoring mechanism to limit the negative tendency of the managers in manipulating reported earnings. The study of institutional holdings is also tested in the work of Ayade (2014) who examine the relationship between ownership structure and earnings quality using a sample of 117 French firms for the period of 2003 to 2011 and reports that institutional ownership is positively related to the earnings management. Also Shehu and Ahmed (2014) studies the interactions between corporate governance structure and earnings management in Nigeria banking industry through discretionary LLP. They use a sample of 8 banks for the period of 2008 to 2011 using

variables such as audit governance score, board size, board composition and institutional ownership and find that corporate governance influences opportunistic accounting in divergence way but institutional ownership inversely related to discretionary LLP. The findings is not in agreement with the result of Elizah & Isenmila (2012).

Also Emamgholipour, Bagheri, Mansourinia and Arabi (2013) test the effect of institutional ownership on earnings manipulation using firms listed on the Tehran Stock Exchange by examining a sample of 700 companies for the period 2006 to 2010. The findings show a positive and significant relationship between earnings management and institutional investors. This suggests that the higher the ownership levels of institutional shareholders increases the higher the possibility of earnings management. The findings contradict the results of Hadani, Goranova and Khan (2011); Sayim and Suleyman (2014). However, the majority of the evidences provide in the literature are from manufacturing industries and are mostly in the developed economies. Also in the emerging market like Nigeria, Elizah and Isenmila (2012) investigates the relationship between institutional ownership and earnings management of Nigeria banks using a random sampling of 10 banks for a period of 2006 to 2010 and finds that institutional ownership has a positive relationship with the earnings management. This result implies that the institutional holdings in Nigeria banks are for short term, they are therefore passive in providing monitoring mechanism to mitigate the negative activities of the managers.

Also, Al-zyoud (2012) studies the association between institutional ownership and Australian firm's aggressive earnings management strategies and find a positive association at the lower institutional ownership level. The study also reveal a negative association at the higher ownership levels. This findings is consistent with the view that long term oriented investors limit managerial accrual discretion. It also implies that institutional ownership does not curtail the activities of the managers on earnings management. Conversely, Farooq and

Jai (2012) also test the influence of institutional holdings in opportunistic accounting using firms listed on the Casablanca stock exchange and report an inverse relationship. But the study of Lin and Manowan (2012) find a significant positive relationship between transient institutional investor ownership (holding diversified portfolios with high turnover) and discretionary accruals for US firms. The study conducts by Joubert and Fakhfakh (2012) shows that some of the strong earnings factors are CEO stock ownership, independent monitoring and institutional investor's property in both the French and Canadian structures.

On the contrary, Hadani, Goranova and Khan (2011) evaluate the relationship between institutional ownership and earnings management and the result reveals that institutional ownership and earnings management are negatively related. In another study of Abdul Jalil and Abdul Rahman (2010), the authors evaluate the influence of institutional ownership on earnings management of 94 firms listed on Bursa Malaysia using three classifications by categorising institutional members into three groups and reveal that all forms of institutional ownership do not constrain opportunistic accounting manipulations. Similarly, Nedal *et al.* (2010) also assess the relationship between ownership structure and earnings management for a sample of Jordanian industrial firms for the period 2001 to 2005 using generalized method of moment (GMM) and find a positive relationship between institutional ownership and earnings management. Yang, Chun and Ramadili, (2009) examine the external directors and institutional shareholders' roles in limiting the earnings management activities of Malaysian companies and reveal inconclusive results.

The findings from the prior studies are mixed, while some studies reveal positive relationship between institutional ownership and earnings management other find a negative relationship between institutional ownership and earnings management. This study therefore agreed with the two positions, because long term institutional ownership provide monitoring mechanism to inhibit earnings management therefore the relationship is negative while short

term institutional ownership are passive and not willing to provide monitoring mechanism to inhibit earnings management. The relationship between short term institutional ownership and earnings management is suggested to be positively related.

2.7.5 Foreign Ownership and Earnings Management

From the viewpoint of agency theory, foreign ownership can replace debt and help firms to perform better control by reducing agency cost of equity holding by the supervisory managers. However, this can only happen when the foreign shareholders create an efficient mechanism of control in the firm. A number of studies argue that foreign ownership is one of the effective corporate structure mechanism that complements other structure mechanism in deterring earnings management. Accordingly, this premise is tested in the study conducted by Muas and Nafiu (2017) who examine the effect of foreign ownership on earnings management using 6 listed conglomerate covering a period of 2008 to 2014 and find a positive relationship between foreign ownership and earnings management. Also, the work of Adebisi and Olowookere (2016) evaluates the relationship between foreign ownership and the quality of financial reporting in the Nigeria DMBs and reveals an inverse relationship between foreign ownership and quality of financial reporting.

Samy, Rezaul and Huy (2016) in another study examine how corporate governance characteristics affect earnings management using a sample of Vietnamese listed firms for the period of 2010 to 2014 and find that foreign ownership is inversely related to opportunistic behaviour of the management. The findings of this study support the result of Anwer and Takuya (2015) which reveal that foreign ownership mitigates earnings management. This debate is assessed in the study conducted by Ahmed and Iwasaki (2015) which investigate the effect of foreign ownership on a monitoring mechanism, monitoring outcome on earnings management and firm' value using a sample of 12,600 firms for a period of 2010 to 2014 and find that foreign ownership is negatively related with both accruals and really earnings

management. The result is in consistent with the expectation of agency theory and corporate governance which stipulate that foreign holdings improve monitoring outcome and constrain managers from engaging in earnings management.

Also, Guo *et al.* (2015) examine foreign ownership and real earnings management using a sample of Japanese firms and find that foreign investors play an independent role in restraining real earnings management, as captured by abnormal cash flow from operations, abnormal discretionary expenses, abnormal production costs, or a composite of the aforementioned three measures. The results are robust to a variety of controls, including economic fundamentals, domestic block - holdings, governance mechanisms, and endogeneity of foreign ownership. The result also indicate that sophisticated foreign investors, with relatively few business ties to local management, improve the accounting oversight of local firms by curbing earnings manipulation via operating activities.

Despite these empirical evidences in favour of the foreign ownership as a means of reducing earnings management by the managers, other researchers propose that managers are tempted to manage earnings in order to raise capital or meet regulatory benchmark (Chen & Yuan, 2004; Haw Qi & Wu as cited in Idris 2012). Similarly, Anwer and Takuya (2015) investigate the effect of foreign ownership on the monitoring mechanism and firms' value using a sample of Japanese firms. The study reveals that foreign ownership is inversely related to the accrual and real earnings management Suwandi, Cape and Abdulhamid (2015) assess the relationship between foreign ownership and earnings management using a sample of 178 firms and apply path analysis method and has an inconclusive result. Juan (2013) assess the effect of foreign ownership and earnings management using a sample of firms from four south European countries (Portugal, Italy, Greece and Spain) for a period of 2002 to 2007 using modified jones model and find that firm level earnings quality is positively related to foreign shareholdings. Also Aharony, Lee and Wong as cited in Idris 2012)

document a positive and significant relationship between foreign ownership and earnings management of the Chinese state - owned enterprises before IPO. However, even if foreign investors were not able to see through the earnings figure and price the shares fairly, the results do not show whether foreign investors were active in constraining earnings management after acquiring the voting rights or not.

Similarly, Ioraver and Wilson (2011) also subject the assumption to test in the study that assess the relationship between ownership structure and firms performance from perspective of listed firms listed on the Nigeria stock exchange and find that foreign ownership has no significant relationship with earnings management. This implies that foreign holdings do not provide monitoring mechanism to checkmate the activities of the managers in Nigeria firms. This study consider all non- financial firms with the exclusion of banking industry. Therefore, the findings could not be generalised in the banking industry. The study also used return on assets as dependant variable instead of accrual model. Ali *et al.* (2008) using Malaysian listed firms and reveal inconclusive result. On the contrary, in the same domain, Kim and Soon (2008) evaluate the relationship between corporate governance and earnings management of the firms listed on Malaysia stock exchange for a period of 2004 and 2005. The result reveals that foreign ownership is significantly related to the opportunistic accounting engage by the managers.

From the above, it is obvious that the postulation of agency theory and the focus of corporate governance is yet to be confirmed true as the prior empirical reviews show mixed findings. Some findings present inverse relationship while some studies present positive relationship and other studies are inconclusive. It is therefore important to subject this debate for further test.

2.7.6 Ownership Concentration and Earnings Management

The issue of whether or not ownership concentration improves the quality of financial reporting remain debatable. This argument is tested in the study of Fransisco and Anna (2017) who examine the effect of ownership concentration on earnings management using a sample of 300 non – financial listed Italian firms and find that ownership concentration earnings management. Also, Musa and Nafiu (2017) evaluate the effect of ownership concentration on earnings management of listed conglomerate in Nigeria and find that ownership concentration is negatively related to earnings management. However, Obigbemi (2017) studies ownership structure and earnings management of companies listed on the Nigeria StoCK Exchange and find that ownership concentration is negatively related to earnings management. In another study, Huy (2016) examines ownership concentration are related to earnings management and find that ownership concentration has no effect on earnings management.

Ahmed and Hansah (2015) also assess the effect of ownership concentration on earnings management of firms listed on new burser Malaysia main market for the period of 2009 to 2012 and find that ownership concentration reduces earnings quality. Similarly, Abdulhadi (2016) examines the effect of ownership structure and earnings management of Nigeria listed banks using a sample of 6 banks for the period of 2009 to 2014 and apply modified jones model by Dechow *et al.* (1995). The study finds a negative and significant relationship between ownership concentration and earnings management. This findings confirm the result of Ikechukwu (2013) who concluded that the higher the ownership concentration the lower the opportunistic accounting. It is obvious that the findings from this studies are mixed due to variation in measurements, models used, domain, legal and regulatory environment. Majority of the prior studies focus their investigation on earnings management from accrual perspectives in determining discretionary behaviour of the

managers. It is therefore important to further investigate the influence of ownership concentration on earnings management in a free cash flow situation to come up with clearer of the relationship between ownership concentration and earnings management.

In another study, Li, Lu, Mittoo and Zhang (2015) assess board independence, ownership concentration and corporate performance of Chinese firms for a period of 2003 to 2008 and find that the impact of board independence on firm performance increases as ownership concentration declines but this effect varies by the types of ownership. The result further reveals that high ownership concentration has a moderating influence on board effectiveness but the effect also depends on ownership types and country's institutional environment.

Also, Vicente, Laetitia and Frank (2014) examine the effect of ownership concentration on earnings management using a sample of European commercial banks over a period of 2004 – 2009 and find that banks practice earnings management through LLP depend on its degree of ownership concentration and regulatory environment. They also report that banks with low level of ownership concentration are found not to involve in such earnings management behaviour throughout. To authenticate this assumption empirically, Ikechukwu (2013) tests the influence of ownership structure on the earnings management of the firms listed in Pakistan Stock Exchange and confirms a positive relationship between ownership concentration and earnings management. This implies that the higher the ownership concentration, the higher the earnings management.

Similarly, Usman and Yero (2012) conduct a study on the examination of ownership structure on earnings management using 30 firm-year parallel observations and find a significant negative relationship between ownership structure and earnings management. The findings therefore conclude that ownership concentration moderates the practice of earnings management in Nigeria. In the same vein, Hassan and Ahmed (2012) study the impact of ownership structure on earnings management using a sample of 8 firms for a period of 2006

to 2010 and find inverse relationship between institutional shareholding and discretionary accrual while ownership concentration and family ownership have positive impact on earnings manipulation.

Stergios and panagiotis (2012) investigate the role of corporate governance in earnings management behavior by US listed banks and obtain data from 2003 to 2008. The study used two different measure of earnings management and find that banks with efficient corporate governance mechanism report small positive income to a lesser extent while a well governed banks engaged in aggressive earnings management behaviour through the use of discretionary loan loss provision and realized security gains and losses. Gebhardt and (2011) use a country level measure of ownership concentration and find that earnings management is higher in European countries where listed banks are widely held.

Gul, Kim and Qiu (2010) investigate the effect of the largest - shareholder ownership concentration on the amount of firm - specific information incorporated into share prices, as measured by stock price synchronization and find that synchronization is a concave function of ownership by the largest shareholders. Conversely, Gunther and Zoltan (2010) examine the implication of IFRS adoption on the accounting quality of banks in 12 EU countries and find that the restriction to incurred losses under IFRS significantly reduces the ability of banks to engage in earnings management. However, the effect is less pronounced in a country with widely dispersed ownership structures and strict bank supervision. This findings further provide evidence that institutions matter in shaping financial reporting outcome However, more evidences of how ownership concentration monitor the level of earnings management is provided in the work of Marcia, Jamie and Hassan (2006) and the work of Hu and Izumida (2008) which indicate that ownership concentration has a significant effect on the contemporary and subsequent corporate performance. The study examine whether corporate governance mechanism affect earnings management at the largest publicly traded bank

holding companies in United States and find that discretionary Loan Loss Provisions is positively related to the bank, unmanaged cash flow, return capital ratio and assets size. They further report that the use of DLLP to manage earnings is significantly related to the fraction of shares owned by the bank chief executive officers (CEO).

Similarly, Leuz *et al.* (2003) examine the differences in ownership concentration of firms across 31 countries and earnings management of listed non-financial firms and find that countries with dispersed ownership structure engage in less earnings management. The findings are consistent with the hypothesis which state that firms use earnings management to conceal the firm's performance from outsiders. In other words, small shareholders would not be interested in monitoring activities because they don't want to incur monitoring costs, but only share a small proportion of the benefit. Consequently, shareholders owning a small fraction of outstanding share have incentives to free-ride in monitoring management (Alves 2012). However, firms with concentrated ownership may be subject to conflicts of interest between majority and minority shareholders. Large shareholders can exercise their control rights to create private benefits, sometimes expropriating minority shareholders (expropriation hypothesis).

2.7.7 Free cash flow and Earnings Management

Jaggi and Gul (2000) assess the relationship between free cash flow and earnings management. The findings reveal a positive relationship between earning management and high free cash flow in firms with low growth. Also, in another study conducted by Bukit and Iskander (2009), the researchers assess whether high surplus free cash flow is related to earnings management moderated by independent committee using a sample of 155 firms listed on the Malaysia stock exchange in 2001 and the result reveals that independent audit committee helps firms with high surplus free cash flow to reduce income increasing earnings management practices. In the same vain, Bhundia (2012) examine the comparative study

between free cash flow and earnings management of the firms listed on Indian Stock Exchange using lens and pouslen model (1989) and Jones model. The findings reveal a positive significant relationship between free cash flow and earnings management. Jones et al. (2001) studied relationship between earning management and free cash flow in the firms with new and old-structured economy in Australia. He observed that there is positive relationship between discretionary accrual items and free cash flow in the firms with an old-structured economy (usually have low growth) because these firms' managers try to compensate their weak performance through discretionary accrual items, but he didn't find significant relationship in the firms with a new-structured economy (with high growth).

Chunget al. (2005) in another development, investigate the relationship between earning management and free cash flow in firms with low growth during the period of 1984-1996. Their research sample consists of 22576 American firms. Their results indicate positive significant relationship between earnings management and free cash flow. Additionally, after survey on relationships among institutional stakeholders, audit firms and high audit quality they found out that the mentioned variables lead to a decrease in the relationship between earnings management and free cash flow and prevent managers from managing the earnings.

Conversely, Teixeira, Martinez and Cardoso (2014) investigate the relationship between free cash flow and earnings management in Brazil using IFRS adoption and shareholding concentration as moderator. The study use firms listed on the BMF and BOVESPA for the period 2008 to 2012. The findings reveal that firms with growth prospective and excess FCF are more likely to manage earnings and increase their reported earnings. Similarly, Gharari and Hassanzadeh (2015) assess the relationship between free cash flow and discretionary accruals using a sample of 63 firms listed on the Tehran stock exchange and found a positive and significant relationship between free cash flow and earnings management. Bukit and Nasution (2015) carry out a test if employee diff, free cash

flow can lead to desires of managers to manipulate earnings in two different condition using a sample of manufacturing firms listed on the Indonesia stock exchange for the period 2011 to 2013 and the findings reveal that manager manipulate reported earnings in the less monitoring firms with free cash flow. Accordingly, Farahan, Mehri and Pooya (2016) examine the effect of free cash flow and earnings management using a sample of 117 enterprises listed on Tehran stock exchange

for a period of 2009 to 2014. The study reveals a direct significant relationship between free cash flow and earnings management in enterprise with high growth but fails to provide evidence of relationship between free cash flow and earnings management in the enterprise with low growth.

2.7.8 Evidence of Moderation effect of Free Cash Flow on the Ownership Structure and Earnings Management

Jensen (1986) assert that the availability of free cash flow after financing good projects reduces conflict between managers and shareholders if the funds is paid out to the shareholders as dividends or super dividends. The conflict of interest between managers and shareholders arises if the managers are reporting earnings and are unable to declare dividends to the shareholders. The firms with strong corporate governance to monitor the activities of the managers on how free cash flow are utilized such as payment of dividends or super dividends tend to have lower conflict between managers and shareholders. The higher the conflict the higher the earnings management and the lower the conflict the lower the earnings management. Because if the conflict is minimal, the managers will not be under pressure to manage the reported earnings. Chi and Scott Lee (2010) asserts that overlooking this conditional nature of corporate governance may lead to erroneous implication that ownership structure and earnings management are not significantly correlated. The presence of strong corporate governance is necessary for firms with excess cash since managers of these firms

are expected to invest in a project with poor returns (e.g. Dittmar & Mahir-Smith, 2007; Chi & ScottLee, 2010).

Dittmar *et al.* (2007) examine the discretionary behaviour of the managers in the free cash flow situation and find that shareholder faces greater challenges in reducing earnings management when there is no available free cash flow. It also reveal that prosperity to manage earnings is stronger in countries with weak protection of minority stockholders.

Agency theory views growth opportunities as important factor in the agency conflict of free cash flow because high growth opportunities firms utilize all available cash to finance project with positive returns compared to firms with low growth opportunities (Jaggi & Gul, 2000). However, the findings from the empirical studies reveal that firms with high free cash flow and growth opportunities reduces earnings management. Because the funds will be used to finance projects with higher returns and the surplus funds distribute to the shareholders will solve the issues of conflict between them but low growth opportunities report low quality earnings because the funds will be used to finance the projects with poor returns if there is no strong corporate governance (Chung et al., 2005; Bukit & Iskandar, 2009). Some studies examine the moderating effect of free cash flow on the ownership structure and earnings management. Prominent among the prior studies is the work of Jensen and Meckling (1976) which examine the opportunistic behaviour of the manager when there is a surplus funds and they are holding high number of shares and find that managers with high shares do not engage in the manipulation of account because they will suffer the consequence of their actions and therefore involve in the optimal utilization of surplus funds.

Also Nekilih (2015) investigates the moderating effect of corporate governance and ownership features in lessening earnings management practice in a free cash flow situation. The study use the sample of France companies from SBF 120 index from 2001 to 2010 and reveal that managers behave opportunistically in a free cash flow situation. It further reveals

that corporate governance mechanisms are substitutive in the monitoring role of managers' behaviour to reduce earnings management in the free cash flow situation.

Moreso, the study conducted by Richardson (2006) also reveal that the non- executive directors activities limit or inhibit the opportunistic activities of the managers in relation to over- investment when there is surplus funds available in the firms. Conversely, Lasfer (2006) examine the influence of non- executive director ownership in relation to the agency cost in a free cash flow induced situation. The study finds that high presence of non – executive director ownership on the board reduces earnings management in a free cash flow situation. Bukit and Iskander (2009) study whether high surplus cash flow is related to earnings management using independent committee as moderator. The study uses a sample of 155 firms listed on the main board of Bursa Malaysia in 2001 and find that independent audit committee helps firms with high surplus free cash flow to reduce income increasing earnings management.

In another development, Chung *et al.* (2005) investigate the influence of free cash flow agency cost, earnings management and investor monitoring using a sample of companies included in the 1999 compusat PC Plus and find that firms with high free cash flow and low growth are associated with low long term profitability. It further reveal that institutional ownership monitoring activities deter managers from using negative discretionary accrual when free cash flow agency cost are potentially high. Accordingly, Lawal (2015) examine the impact of free cash flow and managerial ownership on the agency cos of listed conglomerates in Nigeria for a period of 2007 to 2012 and find a significant relationship in the interaction of free cash flow and high managerial ownership on the agency cost. From the above empirical review, the study therefore concludes that free cash flow moderate the ownership structure in reducing earnings management.

Redwhanand Ku (2011) examine the moderating role of surplus free cash flow on ownership structure and earnings quality of non-financial institutions of firms listed on the Bursa Malaysia for the year 2008 and 2009. The variables used are managerial ownership and institutional ownership. The findings reveal that free cash flow plays a moderating role on the relationship between ownership structure and earnings.

2.8 Theoretical Framework

The theories that underpin this study are agency theory and free cash flow theory. The agency theory observes that conflict of interest exists in a business which may serve as an incentive for a manager to manipulate accounting information since the agent who owns the resources does not have control over the accounting process while the free cash flow theory is of the view that the surplus or free cash-flows left in the hand of managers serve as motivation for earnings management because they are left with the discretion on how the funds are spent. It is in this regard that the study adopts the two theories for its adequacy and relevance in explaining this context.

2.8.1 Agency Theory

The agency theory of Jensen and Meckling (1976) postulates that the separation of ownership and control leads to the conflicts of interests between managers and owners. However, the separation raises serious problems and conflicts between the shareholders of the firms and the managers. These conflicts arise when managers seek to maximize their interests by engaging in activities that are not in line with the objective of optimising shareholders' wealth. Managers are in power and may have the motivation to transfer wealth in terms of bonuses or other benefits at the detriment of the owners (Mashayekhi, 2008). In the light of this, shareholders may face with monitoring costs to observe the activities of the management against unethical actions. This division of ownership and control creates agency problems. The assumption is tested in the work of (Levitt, 1998) who finds a significant

positive relationship between agency conflicts and the degree of division between ownership and control. The findings reveal that as the degree of separation between ownership and power increases, the agency problem and costs also increases. Therefore, effective monitoring is needed to reduce agency problems and costs. To assuage these conflicts of interests, the regulators put in place several corporate governance mechanisms to monitor the activities of the managers. One of the cogent areas of the corporate governance that require the attention of the researchers to be assessed in the light of agency cost is the ownership structure. Ownership structure is presumed to be inversely related to the problem of agency cost. The theory therefore is of the view that when the executive directors and non-executive directors have stake in the firm, the issue of agent costs could be whittled down because they will provide monitoring mechanism to protect their interest in the firm. It is on this note that these study assess the workability of this premise to lend credence to the agency theory or disapprove the proposition. However, the work of (Ali, Salleh, and Hassan, 2010) confirmed a premise that if managers do not have stake in the firms, their behaviour is affected by self-interest that put off their goals of maximizing company value and, consequently, the interests of the shareholders or owners.

Conversely, the study of (Berle and Gardiner as cited in Kazemian and Senusi 2015), report the existence of agency problem between shareholders and managers due to dispersed shareholding in the large enterprises. This arises when the managers take the advantage of disperse ownership to expropriate the minority shareholders. The expropriation of minority shareholders or disperse shareholders is made possible because managers have full information about the underlying economic activities of the firm but fails to disclose to the shareholders the truth picture of the firm. Managers are taking the advantage of their skills, as they are fully aware that the contributors of the funds needed to finance investment, while assuming the risk of acquiring business and ownership of the company but do not possess the

technical - know - how needed to perform the function.

The shareholders are therefore forced to entrust supervision and direction to someone who possesses the qualifications and skills needed to perform this function. If the shareholders have complete information on investment opportunities presented to the organization and firm' managers, they could design complete contracts that could not give full scope for the discretion to the board of directors. But this is not true and the actions of management and investment opportunities are not perfectly observable by the owners , as a result, managers can engage in an opposite conduct to the owners' interests . In other words, managers have incentives to expropriate the company's profits , through projects that benefit them but may have adverse effect on the shareholders (Jensen & Meckling, 1990; Fama 1980).

Jensen and Meckling (1976) develop a model which describe how lower managerial stakes lead to an increase in non-pecuniary spending by the managers as they do not fully internalise their costs and therefore generate agency costs. The agency theory expresses fear in the complexities that can arise under conditions of asymmetric and incomplete information between the principal and the agent. This problem arises when these two parties have different interests. The principal's interest is to maximise wealth while managers' interest is to pursue utility maximisation. In this perspective, agents may have motivations to undertake actions and make decisions that are not in line with owners' interests, when preparing the financial information (Fama & Jensen as cited in Alzoubi 2015).

Callao and Jarne (2010) argue that accounting standards reduces managers' ability to misrepresent accounting numbers or accounting choice. The inflexible and rigid accounting rules offer limited accounting options which restrict the scope for subjective judgments and reduce the managers' ability to behave opportunistically. On the contrary, it has been debated that more flexible rules can provide greater scope of choices to managers

and a certain degree of subjectivity in the implementation and application of accounting standards criteria as

such, managers can be allowed to exercise their discretion (Burgstahler & Dichev as cited in Duranni & cumming 2014). Conversely, the more flexible the accounting rules tend to be, the higher the probability that managers engage in different activities with the intention of manipulating the reported earnings (Jeanjean & Stolowy, 2008).

Prior studies however express worries on some accounting principles that gives managers some discretion. This managerial discretion which is used for manipulation of accounting information has created a lot of integrity issues on the financial statements. However, the code of corporate governance which ownership structure form parts is designed to check the activities of the managers and to improve the confidence of the stakeholders.

The ownership structure is also important as it does not only concern how much the company insiders own, but also how concentrated the holdings of the outside shareholders are as postulated by entrenchment effect hypothesis. The hypothesis assumes that firm with high concentrated owners provides monitoring mechanism to mitigate the negative tendency of the managers and encourages them to act in a way that maximizes the value of the firm (Warfield *et al.* 1995). It was argued that large shareholders monitor the management better than small shareholders, as they internalise larger part of the monitoring costs and have sufficient voting power to influence corporate decisions. In addition, a range of other mechanisms that either align the interests of the managers and owners or limit managerial discretion have been suggested to reduce agency costs. Agency theory suggests the existence of a conflict of interest between all parties in a firm.

2.8.2 Free Cash flow Theory

Jensen (1986) introduced the theory of free cash flow (FCF) and defined it as the cash

flow from operating activities in excess of the funds needed for investment in projects with positive net present value (NPV) when discounted at the relevant cost of capital. The theory postulates that conflicts of interest are lessened when the excess FCF available are distributed to the shareholders. The managers who pay dividends promptly do not have much problem with the shareholders and this is made possible if the firms have surplus funds available to back up their reported earnings. If the funds are available the tendency by the managers to engage in the opportunistic accounting will reduce. After the advent of Jensen (1986) theory of free cash flow, Bhundia (2012) tested the assumption and lays more voice in support of the view that the greatest agency problems only arise when there is absence of corporate governance to provide monitoring mechanism in the allocation of FCF.

The question of how effective or efficient the FCF is utilized to optimize shareholders' wealth could only be answered by the effective monitoring provided by the insiders owners. They further state that the conflict of interest between shareholders and managers over the dividend pay-out policy is austere when the organization generates large FCF. This is reflected in the problem of how to persuade managers to increase dividends instead of making investments with returns below the cost of capital or wasting cash through inefficiencies.

According to Jensen (1986), managers and stockholders are in conflict regarding the optimal size of the firm and payment of dividends, especially in firms with excess FCF and low growth perspective as this serves as a motivation for opportunistic accounting. In this situation, managers can either increase dividends or invest in projects with low return, wasting these resources. The FCF theory also opines that paying dividends reduces conflict, since it reduces the amount of resources under the control of the managers which diminishes their power. This reduction of resources makes it difficult for managers to think of engaging in financing projects that are less likely to bring return. Free cash flow theory also assumes

that managers have inducements to cause the firm to grow beyond its ideal size in order to increase their powers since the resources are raised under their control with a consequent increase in their remuneration as a result of positive correlation between growth of sales and executive compensation. But the insiders have stake such as executive and non – executive director ownership, there is tendency to provide monitoring mechanism to inhibit managers in engaging earnings management. This is possible especially if the executive directors have substantial stakes in the system, they may want to guide their resources jealously. But firms with little or no insider stake such as executive director ownership, non- executive director ownership or long term institutional ownership end up wasting the excess cash flow available to them in unprofitable projects (Jensen, 1986).

Subsequently, the existence of a substantial level of FCF might lead managers to opt for sub-optimal investment policies if not properly monitored. This premise is tested in the study conducted by Rusmin, et al. (2014) which reports that managers conceal their projects counter-performance by engaging in aggressive earnings management practices. Two situations described in the literature are possible. The first one occurs when managers manipulate their earnings upwardly to conceal counter-performance and the second situation arises when managers opt for downward earnings management to smooth earnings in the following years, when the negative impact of sub-optimal investment begins to appear.

Managers' behavior is dependent on the ownership and corporate governance characteristics that can determine their margin of discretion and thus guide surplus funds use. These features should become all the more influential when minority holders' legal protection is not guaranteed. They can directly impact managers' propensity to manage earnings; or indirectly by reducing the FCF level. As a matter of fact, the issue of how managers utilize FCF needs to be tackled empirically, otherwise, the ownership structure which is seen as the solution to the agency cost will ever remain a mere academic exercise. This assumption is

tested and validated in the study of Jaggi and Gul (2000) which reveal a positive relationship between earnings management and high free cash flow in firms with low growth. In the same vein, the study of Bhundia (2012) investigates the assumption and find a positive significant relationship between free cash flow and earnings management.

Other prior studies that examine the presumption of Jensen (1986) include Chung *et al.* (2005); Teixeira *et al.* (2014); Gharari & Hassanzadeh (2015); Bukit & Nasution (2015); Farahan, Mehri & Pooya (2016). The findings from these studies confirm a positive relationship between free cash flow and earnings management. Therefore managers use free cash flow to manipulate the reported earnings. It is on this base that this study consider free cash flow theory sufficient and relevant to explain the relationship between free cash flow and earnings management.

2.9 Summary

The study reviews conceptual issues relating to the research topic. Also review are different definitions of earnings management from different perspectives, since there is no generally accepted definition of earnings management. Some studies see earnings management as a crime since the managers intentionally distort accounting information to mislead the stakeholders while some studies view earnings management as an attempt by managers to maintain stable profits over a period of time to avoid fluctuations in reported earnings and therefore conclude that so long as accountants manipulate or distort financial reporting within the purview of GAAP, no crime is committed in a country where laws do not forbid it.

The study also observed that, despite numerous studies that investigate the effect of ownership structure on earnings management, there is a few empirical evidences on the influences of ownership structure on earnings management of the banking industry in the emerging market via loan loss provisions. It also observe that there is dearth of research on

the interaction of free cash flow on the relationship between ownership structure and earnings management in the emerging market like Nigeria. Also discussed is the agency theory and free cash flow theory that underpin this study.

The agency theory postulate that the separation of ownership and control leads to the conflicts of interests between managers and owners. These conflicts arise when managers seek to maximize their interests and engage in activities that are not in line with the objective of maximizing shareholders' wealth and to mitigate these conflicts of interests, the shareholders put in place several corporate governance mechanisms to monitor the activities of the managers. One of the components of corporate governance to mitigate earnings management activities by the managers is ownership structure. The Agency theory therefore explain both ownership structure and earnings management. In the same vain, free cash flow theory views that conflict of interest between managers and shareholders is reduced when firms have free cash flow in the system for payment of dividend or investment. . According to Jensen (1986), paying dividends reduces conflicts between managers and shareholders, since it reduces the amount of resources under the control of the managers, therefore the motivation for accounting manipulation is also reduced.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology for the study. The method includes research design, population of the study, sources of data, analytical techniques and other analyses that are considered necessary for testing the relationship between the dependent and independent variables. The study considers ownership structure variables such as executive director ownership, non – executive director ownership, institutional ownership, ownership concentration, and foreign ownership as independent variables and earnings management as dependant variable. The study also discusses the interaction of moderating variable ie the interaction of free cash flow with executive director ownership, non-executive director ownership and institutional ownership.

3.2 Research Design

The study adopts Correlational research which forms part of causal research design. The study employs this design to assess the extent of the relationship between ownership structure and earnings management and the moderating role of free cash flow on the relationship between ownership structure and earnings management. The Correlational study measures the strength of the association and the nature of the relationship between two or more variables. The design is informed by the positivism research paradigm that is scientific, quantitative and deductive in nature. It uses statistical tools to analyse the data collected and draw conclusions to validate or nullify the theory.

3.3 Population and Sample of the Study

The population and sample of the study consist of fourteen DMBs listed on the Nigerian Stock Exchange (NSE) as at 31st December 2016 (NSE Daily Official Listing, 2016). All the listed DMBs on the Nigeria Stock Exchange as at 31st December, 2016 is

also taken as the sample of the study. The population and sample of listed DMBs are attached in Appendix (1).

3.4 Source of Data

The data collected for this study is obtained exclusively from the secondary source. The data used for this study is extracted from the financial statements of the listed DMBs for the period 2007 to 2016. The secondary source is more appropriate because all information needed for the study are available in the banks' financial statements.

3.5 Method of Data Collection

The study obtained the data from the financial statements of the listed DMBs as at 31st December, 2016 via download from the banks' website. The procedure adopted in obtaining the data entails scrutinising the sources, identifying the data of interest and collecting them manually on the excel sheet.

3.6 Technique of Data Analysis

The study adopts Ordinary Least Square (OLS) multiple regression as a tool for data analysis. This method is relevant to the study and the data for the study is a balance panel data. It has the characteristics of both cross – sectional data and time series data. The panel data gives more informative data, more variability, less collinearity among variables, more degree of freedom and more efficiency. It can detect and measure the effects that simply cannot be observed in cross- sectional or time series data (Gujarati 2009). The analytical tool is sophisticated enough to handle the relationship between two or more variables in the panel data and has dominated empirical studies in the existing literature. Also, the technique is consider appropriate for the study when the data collected fulfils the OLS classical assumption assumptions;

- i. Normality of residual (residual plot) – Shapiro or jeck vera.
- ii. Linearity (Non – Linearity check)

- iii. Homoscedasticity (hettest)
- iv. Independence (Durbin Watson) for time series or macro panel
- v. Absence of multicollinearity (VIF)

3.6.1 Robustness Tests

The study performed robustness tests to ensure that all the underline assumptions for OLS are fulfilled. These include Kernal Density Estimate for normality of residual, multicollinearity test using the variance inflation factor (VIF) and the Brusch-Pagan/Cock-Weisberg test for heteroscedasticity. Similarly, the study controlled for fixed and random effect models because of the panel approach for regression and also test for suitability of the two models using Hausman specification test. The hausman specification test is conducted to decide between the fixed effect and error component model (random effect). The test examines whether there are substantial differences between the pool regression and the fixed effect regression. In this regards, the null hypothesis assumes that there is no significant difference in the estimated co-efficient of the two models. Therefore the (H_0) assumes that random effect is more appropriate. However, the (H_0) for this study is that executive director ownership, non – executive director ownership, institutional ownership, foreign ownership and ownership concentration are not exogenous. If the probability χ^2 is significant, the null hypothesis is reject otherwise, the study will fail to reject. The random effect model is consistent even if the true model is pooled estimator. However, if the true model is fixed effect, the random effect estimator is inconsistent. Thus, if the result favours random effect model, the Breusch and Pagan Lagrange Multiplier test for panel effect will be used to confirm the hypothesis that there are no random effect. This test will help in identifying the appropriateness of the choice between random effect and OLS regression estimates.

3.7 Model Specification and Variables Measurement

In order to curb the limitation of using Loan Loss Provisions, the study adopts two-stage regressions. The first stage regression is run to separate discretionary Loan Loss Provisions from non- discretionary Loan Loss Provisions. The researcher therefore run the first regression using Loan Loss Provisions as dependant variable against explanatory variables such as the beginning balance of loan loss allowance, change in non - performing loan, loan charged – off, loan size to obtain the error term or residual. This procedure is repeated cross – sectional for nine times to obtain residual for each year and the residual (discretionary accrual) is proxy for earnings management (McNichols & Wilson (1988); Kothari *et al.* cited in Ahmed et al. (2014); Beathy and leo ascited in Hansen (2015).

The second stage regression uses the proxy of earnings management obtained in the first stage to regress against ownership structure variables. The ownership structure variables are executive director ownership, non – executive director ownership, ownership concentration, institutional ownership and foreign ownership Greenawalt & Sinkey (1988); Ma (1988) Petroni (1992), wahlen (1994); Beaver and Engel (1996). The study also use moderating variable, that is, free cash flow to moderate the relationship between executive director ownership, non- executive director ownership and institutional ownership. The free cash flow measure cash flow from operating activities in excess of the funds needed for investment in projects with positive net present value (NPV) when discounted at the relevant cost of capital (Jensen, 1986). Following Drakes (2006) as cited in Yero and Usman (2017), the study measure free cash flow for each firms using cash flow approach as follow:

$$FCF = CFO + \{ \text{Interest (1-tax rate)} - \text{Net capital expenditure} \}$$

Where

FCF = Free cash flow

CFO = Cash flow from operations

Tax rate = corporate tax ruling at the date of the financial year

Net capital expenditure = Cash expended on fixed assets acquisition – cash realized on fixed assets disposal.

Free cash flow is scaled by the total assets at the beginning of the year to avoid heteroscedasticity. It follows the approach of Jensen (1986).

Control Variable

The study uses firm size as the control variable. This is because firm size relate to the internal control system. The large firms engage team of competent and qualify personnel to manage their affairs. The larger the firm the more information available to the stakeholders especially investors for investment decision. In this regards, the study conducted by Choi (2002) report that the large firm have motivation for earnings management than small firms because large firms are critical to the outsiders and trying to avoid political cost. The log of total assets is used as proxy for firm size.

3.7.1 Discretionary Loan Loss Provision Model

The specific accrual model developed and used by Greenawalt and Sinkey (1988); Ma (1988); Petroni (1992); wahlen (1994); Beaver and Engel (1996); Beneish (1997); Beaver and McNichols (1998) and Phillips, Pincus and Rego (2003); wahlen (1994); Ahmed, Mohammed and Adisa (2014) are adopted for the study. The study of Ahmed, Mohammed and Adisa (2014) used beginning balance of loan loss allowance LLA_{i-t} and loan charge – off (LCO). The study of Greenawalt and Sinkey (1988); Ma (1988) Petroni (1992), wahlen (1994) used change in non- performing loan. This study introduced loan growth in the model.

LLP = f [(non-discretionary), (discretionary), (control variables)]

Regression Model for estimation of Earnings Management

$$LLP_{it} = a_0 + B_1 LLA_{i,t} + B_2 LCO_{it} + B_3 \Delta NPL_{it} + B_4 LG_{it} + B_5 \log TA_{it} + e_{it} \quad (1)$$

$$\frac{LLP_{it}}{TA_{it-1}} = a_0 \frac{1}{TA_{it-1}} + \beta_1 \frac{LLA_{it-1}}{TA_{it-1}} + \beta_2 \frac{LCO_{it}}{TA_{it-1}} + \beta_3 \frac{\Delta NPL_{it}}{TA_{it-1}} + \beta_4 \frac{LG_{it}}{TA_{it-1}} + \log TA_{it} + e_{it}$$

$$DLLP_{it} = LLP_{it} - (a_0 + B_1 LLA_{i,t} + B_2 LCO_{it} + B_3 \Delta NPL_{it} + B_4 LG_{it} + \beta_5 \log TA_{it}) \quad (2)$$

$$\frac{DLLP_{it}}{TA_{it-1}} = \frac{LLP_{it}}{TA_{it-1}} \left(a_0 \frac{1}{TA_{it-1}} + \beta_1 \frac{LLA_{it-1}}{TA_{it-1}} + \beta_2 \frac{LCO_{it}}{TA_{it-1}} + \beta_3 \frac{\Delta NPL_{it}}{TA_{it-1}} + \beta_4 \frac{LG_{it}}{TA_{it-1}} + \log TA_{it} + e_{it} \right)$$

Where

dllp = Discretionary Loan Loss Provision

LLP = Loan Loss Provisions

LLA_{IT-1} = Beginning balance of loan loss Allowance

LCO_{it} = Loan charge - off

ΔNPL_{it} = Change in non- performing loan

LG_{it} = Loan growth

LogTA = Log of Total Assets

i denotes bank and *t* is for time and e_{it} is error term

All variables are scaled by lagged total assets.

However, the first regression model is used for the estimation of residual. The residual obtained from the first regression is the discretionary loan loss provision (dllp) which will be used as proxy for earnings management in the model for testing hypotheses.

3.7.2 Model for Testing Hypotheses

The discretionary loan loss provision (dllp) estimated from the first regression serves as dependent variable while the ownership structure variables such as executive director ownership, non- executive director ownership, ownership concentration, institutional

ownership, and foreign ownership is used as independent variables and the free cash flow is a moderator to interact with the executive director ownership, non – executive director ownership and institutional ownership. In determining the moderation role of free cash flow, the study uses the improvement in R^2 and coefficient value of the variables to know whether the moderator strengthen the relationship. The Control variable to be used is the firm size, that is, the log of total assets to take care of the issue of different sizes in the bank.

The model is as stated below;

$$dllp = \alpha_0 + \beta_1 exed_{it} + \beta_2 nexed_{it} + \beta_3 ownco_{it} + \beta_4 instow_{it} + \beta_5 forown_{it} + \beta_6 cflo + \beta_7 exed * cflo_{it} + \beta_8 nexed * cflo_{it} + \beta_9 instow * cflo_{it} + LogTA_{it} + e_{it}$$

Where;

$dllp$ = Discretionary Loan Loss Provisions proxy for earnings management or error term

$exed$ = Executive Director Ownership

$nexed$ = Non- Executive Director Ownership

$ownco$ = Ownership concentration

$instow$ = Institutional ownership

$forown$ = Foreign ownership

$cflo$ = Free cash flow

$exed * cflo$ = Executive director ownership interaction with free cash flow

$nexed * cflo$ = Non-executive director ownership interaction with free cash flow

$instow * cflo$ = Institutional ownership interaction with free cash flow

$LogTA$ = Firm Size

Where i denotes bank and t is for time and e_{it} is error term

The table below presents variables definitions and measurements.

Table 3.1: Variables Definition and Measurement

Variable	Measurement	Source
LLP	LLP denotes loan loss provisions. It measures the sum of the ending balance for bad and doubtful debts and loan charge off less the beginning balance of allowance for bad debts. $LLP = a_0 + LLP_{i-t} + \Delta NPL_{it} + LCO_{it} + LG_{it} + lgTA$	McNichols and Wilson (1988), Hassan and Wall (2004); katagarantem, Lobo and Yang (2005) Ahmed, Mohammed and Adisa (2014)
Dllp	dllp denotes discretionary loan loss provisions. It is the percentage of absolute discretionary LLP to TA. The higher the value of the /DLLP/ the higher the earnings manipulation through LLP. The absolute value is considered because the interest of the study is on the magnitude and not whether the earnings is managed upward or downward. $Dllp = LLP_{it} - (a_0 + LLP_{i-t} + \Delta NPL_{it} + LCO_{it} + LG_{it} + lgTA)$	McNichols and Wilson (1988), Hassan and Wall (2004); katagarantem, Lobo and Yang (2005) Ahmed, Mohammed and Adisa (2014)
ΔNPL	ΔNPL denotes change in non- performing loan. Change in non- performing loan is scaled by lagged total assets. It measures overall risk profile of the bank and positive coefficient is expected. $\Delta NPL = NPL_{i+t} - NPL_{i-t}$	Kanagaretnam et al (2000)
LogTA	Log of total assets is used as a control variable for banks size. Total assets = current assets plus fixed assets. The current assets are customer deposit, cash, receivables, prepayments etc while fixed assets are property plant & Equipment, office equipment, motor vehicles etc.	Greenerwalt and Sinkey (1988), Neila (2010)
LG	Loan growth or loan size measures overall risk profile of the bank and a positive coefficient is expected. $LG = LS_{it} - LS_{it-1}$	Leaven and Majnoni (2003)
LCO	Loan Charge off or Loan written off measures future loan default and a positive coefficient is expected. $LCO = BD_{it} - BD_{i-t}$	McNichols and Wilson (1988), Ahmed, Mohammed and Adisa (2014)
LLA	The beginning balance of loan loss allowance measures bad and doubtful debt of the firm. $LLA = LLP_{it}$	McNichols and Wilson (1988), Ahmed, Mohammed and Adisa (2014)

Exed	<p>exed stands for the Executive Director Ownership. The executive director ownership is the percentage of shares hold by the executive directors in relation to the total shareholding of the firm. It is part of corporate governance tools for monitoring.</p> <p>$exed = \frac{exed}{total\ outstanding\ shares}$. The expected sign is Negative.</p>	Ahmed and Shehu (2014);Alves (2014)
Nexed	<p>This nexed denotes Non – Executive Director Ownership. The non- executive director ownership is the percentage of the share holding by non- executive directors in relation to the total outstanding shares of the firm. It is part of corporate governance mechanism for monitoring.</p> <p>$nexed = \frac{nexed}{total\ outstanding\ shares}$</p> <p>The expected sign is Negative.</p>	Leuz, Nanda, and Wysocki (2003); Ahmed and Shehu (2014)
Ownc	<p>ownc denotes ownership concentration. It measures 5% and above block holding in relation to the outstanding shares.</p> <p>$Ownc = \frac{5\% \text{ block-holding shares}}{total\ outstanding\ shares}$</p> <p>The expected sign is positive.</p>	Morck te,al (1988); Fang and Wong (2002);Leuz (2003) and Alves (2012)
Instow	<p>instow denotes Institutional ownership. Institutional ownership is the percentage of shares holding by the institutions in relation to the total shareholding of the firm.</p> <p>$Instow = \frac{instow}{total\ outstanding\ shares}$</p> <p>The expected sign is either positive or negative.</p>	Leuz, Nanda, and Wysocki (2003).
Forown	<p>forown symbolizes foreign ownership. Foreign ownership is the percentage of shares own by foreigners in relation to the total shareholding of the firm.</p> <p>$forown = \frac{forown}{outstanding\ shares}$</p> <p>The expected sign is negative.</p>	Leuz, Nanda, and Wysocki (2003).
Cflo	<p>cflo stands for free cash flow. Free cash flow measures cash flow from operating activities in excess of the funds needed for investment in projects with positive net present value (NPV) when discounted at the relevant cost of capital. It serves as a moderator in the study.</p> <p>$Cflo = cf + (interest \{ 1-rate) -NCE/TA$</p> <p>The expected sign is either positive or negative</p>	Morck te,al (1988); Fang and Wong (2002);Leuz (2003) and Alves (2012)
exed*cflo	<p>exed*cflo symbolizes the interaction between Executive Director Ownership and free cash flow.</p>	Redwhan and Ku (2011)
nexed*cflo	<p>nexed*cflo denotes the interaction between non-executive director ownership and free cash flow.</p>	Nekhili (2015)

instow*cflo

instow*cflo stands for the interactions between Redwhan and Ku
institutional ownership and free cash flow (2011)

Source: Author, 2017

CHAPTER FOUR: DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter analyses the data and discusses the results. The data collected are analysed in the following sequence; summary of descriptive statistics, correlation matrix, regression analysis and robustness tests. The data are analysed with the aid of software Stata 13. It also present regression result with robustness tests for validation of the findings. Finally, it discusses the practical and theoretical policy implications of the findings.

4.2 Descriptive Statistics

Descriptive statistics offers a numerical index that summarises the characteristics or behaviour of the distribution. The numerical data are summarised in terms of means, standard deviation, minimum and maximum. The result is as shown in the 4.1

Table 4.1: Descriptive Statistics of Ownership Structure and Earnings Management

Variable	Obs	Mean	Std. Dev.	Min	Max
Dllp	140	0.070	0.025	0.000	0.136
Exed	140	0.009	0.008	0.000	0.059
Nexed	140	0.026	0.017	0.000	0.083
Instow	140	0.096	0.107	0.004	0.606
Forown	140	0.185	0.113	0.015	0.860
Owncon	140	0.113	0.041	0.001	0.256
Cflo	140	0.025	0.139	-0.523	0.410
exed*cflo	140	0.000	0.001	-0.011	0.009
nexed*cflo	140	0.001	0.004	-0.013	0.027
instow*cflo	140	0.005	0.031	-0.186	0.178
logTA	140	17.425	3.089	10.166	21.519

Source: Computed from the Annual Report and Account using Stata 13 Output

From the table, the average discretionary Loan Loss Provision (dllp) (proxy for earnings management) engaged by DMBs is 0.070 with a standard deviation of 2.5%. It also has a minimum and maximum value of 0.6% and 13.6% respectively. The standard deviation of 2.5% shows the extent of dispersion or deviation of the data from the mean. However the minimum and maximum values reveals that all DMBs in Nigeria engaged in earnings

management but some banks are more aggressive in earnings management than the others due to different level of pressure mounted on them by the stakeholders.

The executive director ownership (exed) has a mean of 0.0093 with a standard deviation of 0.8% a minimum of approximately 0% and a maximum of 6%. This shows that the average stake of the executive directors in the DMBs is less than one percent which is very low. This might encourage them to manipulate reported earnings. The minimum and maximum values in the table show that some executive directors of DMBs in Nigeria do not have ownership at all while others have ownership up to 6%. The non - executive directors' ownership (nexed) has a mean value of 0.026 with a standard deviation of 1.7%, a minimum of approximately 0% and a maximum of 8.3%. This means that the non – executive director holdings in the DMBs on the average is 2.6% although low but far better than the executive director stake. The minimum and maximum values indicates that some non- executive directors of DMBs in Nigeria do not have holdings at all while others have holdings above 8.3%.

The institution ownership (instow) has a mean of 0.097 with a standard deviation of 10.7% and a minimum and maximum values of 0.4% and 60.6% respectively. This means that the institutional or indirect holdings in the ownership structure of DMBs in Nigeria is on the average of 10.7% and the wide dispersion of standard deviation from mean value signifies that the institutional holdings are widely spread. The institutional holdings in the banks are as low as 0.4% and as high as 60.6%. The implication is that banks are exposed to the influence and dictate of institutional ownership and the risk of taking over the business is high in those banks. The foreign ownership (forown) has a mean of 0.185 with standard deviation of 11.4% and a minimum and maximum value of 1.5% and 86% respectively. This descriptions reveal a close variability between mean and standard deviation. The average foreign holdings of 9.7% in the banks is low because the technical and expatriate experience of foreign investors

are needed on the board of the banks to provide monitoring mechanism to curtail the unethical behaviour of managers. The minimum and maximum values signifies that foreign ownership is as low as 1.5% and as high as 86%. This means that there are banks that do not have good investment from foreign ownership while otherbanks are prone to foreign investors' influence because of their quantum of investment.

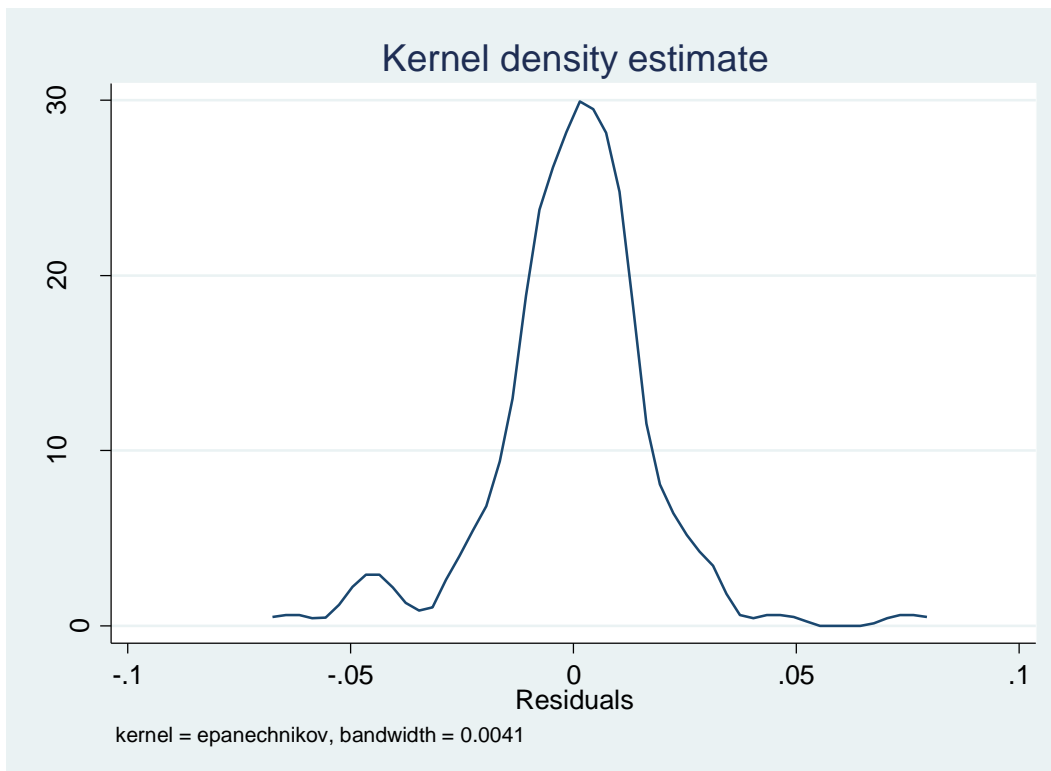
The ownership concentration (ownc) has a mean of 0.113 with a standard deviation of 4.2% and a minimum value of 0.1% while the maximum value is 25.6%. This shows that the level of variation between the mean and standard deviation is not wide. The mean value of 11.3% indicates that on the average, the ownership mix is widely disperse. This might whittle down the monitoring mechanism of the ownership concentration and encourage earnings management because of the expropriation of minority shareholder by the few majority holders. It further reveal that the highest ownership concentration is above 25% while the lowest is 0.1%. The result shows that banks are widely disperse with minority shareholdings. The control variable (firm size) proxy by log of total assets has a mean of 17.7 and a standard deviation of 3.03 and a minimum value of 10.2 and a maximum value of 21.52 signifies a substantial variation in the size of the understudied banks.

Finally, the moderating variable free cash-flow (cflo) has a mean of 0.025 with a standard deviation of 13.8%. It also have a minimum and maximum value of -52.3% and 41.08% respectively. This signifies that banks used above 41% of the internal cash flow from operations to finance their activities while others used cash flow from external sources to finance the activities of the banks. The dispersion of a standard deviation from the mean indicates the extent of cash- flows plough into the business to influence the level of earnings.

4.3 Test for Normality of Residual

The study carry out test for normality of the residual using Kernal Density estimate for normality of residual.

Figure IV. I
Curve for Normality of Residual



Source: Computed from the Annual Report and Accounts using Stata 13 Output

From the figure 4.1 above, the shape of the curve is identical to the normal distribution and it is mesokurtic in nature. The test shows that the residuals are normally distributed thereby satisfying an assumption of OLS regression of normality.

4.4 Correlation Matrix

The correlation matrix is used to check for the linearity assumption of ordinary least square to ascertain the nature of the relationship between the dependent and independent variables. It also check whether or not multicollinearity exists as a result of correlation amongst variables. A perfect correlation of 1 or -1 indicates that the value of the variable can

be assessed exactly by knowing the value of the other variable. Also, a correlation of 0 indicates no relationship between the two variables. The size of the absolute value provides an insight to the strength of relationship between variables.

Table 4.2a: Correlation Matrix 1

	Dllp	Exed	nexed	instow	forow	ownc	cflo	exed*c flo	nexed * Cflo	instow * cflo
Dllp	1.000									
Exed	0.329	1.000								
Nexed	0.079	0.542	1.000							
Insow	-0.229	-0.201	0.413	1.000						
Forow	-0.308	-0.096	-0.174	-0.202	1.000					
Ownc	0.519	0.085	0.198	0.059	-0.325	1.000				
Cflo	0.087	-0.016	0.202	0.228	-0.013	0.009	1.000			
exed*cflo	0.161	-0.067	0.301	0.028	-0.009	0.116	0.667	1.000		
nexed*cflo	0.105	0.075	0.401	0.354	-0.110	0.087	0.83	0.627	1.000	
instow*cflo	0.011	-0.104	0.243	0.339	-0.064	0.015	0.67	0.249	0.789	1.000
Forowncflo	-0.085	-0.004	-0.023	0.019	0.381	0.181	0.84*	0.227	0.203	0.136
Owncflo	0.219	0.03	0.22	0.201	0.134	0.150	0.92	0.697	0.880*	0.234
Log TA	0.119	0.034	-0.076	-0.366	0.036	0.160	0.92	0.152	-0.112	-0.184

Source: Computed from the Annual Report and Accounts using Stata 13 Output

Correlation Matrix 1 cont,d

	Forowncflo	Owncflo	logTA
forowncflo	1.000		
Owncflo	0.234	1.000	
Log TA	0.138	0.080	1.000

Source: Computed from the Annual Report and Accounts using Stata 13 Output

The correlation matrix indicates that foreign ownership interaction with free cash flow has 0.84 correlation with free cash flow while ownership concentration interaction with free cash flow has 0.88 with non-executive director ownership, free cash flow interaction. The two variables with correlation above 0.8 are highly correlated according to (Gujarati, 2009). . The study therefore dropped the two variables to avoid multicollinearity.

Table 4.2b: Correlation Matrix 2

	Dllp	exed	nexed	instow	forow	ownc	exed* cflo	nexed * Cflo	instow* cflo
Dllp	1.000								
Exed	0.293	1.000							
Nexed	0.053	0.523	1.000						
Instow	-0.244	-0.203	0.360	1.000					
Forow	-0.338	-0.042	-0.147	-0.393	1.000				
Ownc	0.452	0.085	0.209	0.057	-0.262	1.000			
exed*cflo	0.146	-0.052	0.295	0.029	-0.007	0.110	1.000		
nexed*cflo	0.083	0.090	0.396	0.329	-0.245	0.087	0.633	1.000	
instow*cflo	0.002	-0.087	0.245	0.318	-0.204	0.022	0.259	0.791	1.000
Fsz(logTA)	0.143	-0.057	-0.097	-0.320	0.279	0.155	0.132	-0.131	-0.193
Cflo	0.063	0.005	0.231	0.120	-0.171	0.030	0.661	0.818	0.669

Source: Computed from the Annual Report and Accounts using Stata Software

The correlation matrix indicates that institutional ownership and foreign ownership have inverse relationship with earnings management. This shows that an increase in the two variables lead to a decrease in the earnings management holding other factors constant. Other variables such as executive directors' ownership, non – executive directors' ownership and ownership concentration have positive relationship with earnings management. This reveals that an increase in each of the three variables lead to an increase in earnings management. Also, the control variable firm size has a positive relationship with the earnings management. It signifies that an increase in the firm size lead to a rise in earnings management. It means that the higher the bank size the higher the earnings management. Finally, the moderating variable free cash-flows have a positive relationship with earnings management. It shows that the higher the free cash – flows in the system the higher the accounting manipulations.

In considering the relationship among independent variables, the executive directors' ownership, non – executive directors' ownership and ownership concentration move in the positive direction. On the contrary, institutional ownership, foreign ownership, free cash flow and firm size are inversely related to the executive director ownership. The non – executive directors' ownership is positively related to all the variables with the exception of foreign ownership and firm size.

Lastly, the correlation coefficient among independent variables are within the threshold of 0.80 as suggested by Gujarati (2009) with the exception of the correlation between non- executive director ownership, free cash flow interaction and free cash flow of (0.818). It is important to note that the result is suggesting the existence of high correlation between non- executive directors’ ownership and free cash – flow which may be harmful or lead to inflation standard errors and bias estimate. It is therefore necessary to use variance inflation factor (VIF) which is more robust to detect the presence of multicollinearity.

4.5 Multicollinearity Test

The study carry out variance inflation factor (VIF) and tolerance value (TV) to ascertain the validity of existence of multicollinearity as pointed in the correlation matrix table 4.3. The correlation coefficient presented in table 4.3 indicates the likely presence of multicollinearity between non- executive directors’ ownership, free cash flow interaction and free cash – flow of (0.818). This further call for advance test to be conducted using the above mentioned test. This test provides the exact correlation among independent variables and sufficient assurance that the research findings are adequate and consistent. The findings from this test will clear the doubt casted on the relationship between non- executive director ownership and free cash flow.

Table 4.3a: Multicollinearity test

VARIABLES	VARIANCE INFLATION FACTOR (VIF)	TOLERANCE (1/VIF)
nexed*cfl	8.78	0.113
instowc*flo	5.45	0.183
exed*cflo	4.67	0.214
Cflo	4.06	0.246
Nexed	3.19	0.313
Exed	3.19	0.313
Instow	2.61	0.383
Forown	1.41	0.708
logTA	1.31	0.762
Ownc	1.20	0.834
mean VIF	3.59	

Source: Computed from the Annual Report and Account using Stata 13 Output

From the result in table 4.4, the VIF value and 1/VIF which ranges from 3.59 to 8.78 and 0.83 to 0.11 respectively with a mean value of 3.59 signifies the absence of harmful collinearity among the explanatory variables. Variables with VIF value above 10 and 1/VIF below 0.1 signifies the existence of excessive correlation (Gujarati, 2009). However, the result from multicollinearity test shows that the VIF is less than 10 while the 1/VIF is above 0.1. Therefore, this signifies the absence of multicollinearity and the regression model is well fitted. Lastly, the result concludes that, there is no exact linear relationship among regressors or non of the regressors can be written as exact linear combinations of the remaining regressors in the model.

4.5.1 Test of Heteroskedasticity

The study carries out a test for the existence of heteroscedasticity using Breusch – pagan / Cook – Weisberg test for the homoscedasticity assumption of the OLS regression. The homoscedasticity assumes a constant variance of the residuals. The decision rules is that, if the P- value is significant at 10% there is sufficient proof to reject the null hypothesis. The result of the test is as presented below.

Table 4.3b: Breusch Pagan/ Cook – Weisberg test for heteroscedasticity

Ho: Constant variance		
Variable: Fitted value of dllp		
Chi2 (1)	=	3.57
Prob> Chi2	=	0.058

However, the result from the above test indicates the chi – square of 3.57 and the probability of 0.058. The result signifies that the null hypothesis is significant at 10% therefore the null hypothesis is rejected. This indicates that the homoscedasticity assumption is not met, therefore there is presence of heteroscedasticity. In order to correct the presence of

heteroscedasticity, the study uses robust OLS regression as the technique for analysis. Considering the nature of the data, the study envisage that the OLS may not provide efficient estimates. In the light of this, the study uses generalized least square to run test for Fixed Effect Model and Error Component Model (ECM) or Random Effect Model. After this test, the Hausman specification test will be performed to make appropriate choice between Fixed Effect Model (FEM) and Error Component Model (ECM) or Random Effect Model.

The test for fixed effect and random effect is carried out and the result is as stated in table 4.5 and 4.6 below.

Table 4.4: Fixed Effect

Dllp	Coef.	Std. Error	T	Prob.	95% Conf.	Interval
exed	1.063	0.351	3.02	0.003	0.366	1.760
nexed	-0.354	0.179	-1.98	0.051	-709	0.000
instow	0.043	0.026	-1.68	0.096	-0.095	0.008
forown	-0.816	0.019	-4.36	0.000	-0.118	0.008
ownc	0.194	0.043	4.49	0.000	0.109	-.045
exed*cflo	3.509	2.404	1.46	0.147	-1.252	0.280
nexed*cflo	-0.582	1.122	-0.52	0.605	-2.803	8.271
instow*cflo	0.151	0.133	1.14	0.257	-0.112	1.640
logTA	0.001	0.000	1.92	0.057	-0.000	0.031
cflo	-0.017	0.241	-0.71	0.481	-0.065	0.069

Source: Computed from the Annual Report and Account using Stata Software

Table 4.5: Random Effect

Dllp	Coef.	Std. Error	Z	Prob.	95% Conf.	Interval
exed	1.023	0.333	3.07	0.002	0.370	1.678
nexed	-0.324	0.172	-1.88	0.060	-0.660	0.013
instow	-0.052	0.024	-2.16	0.031	-0.100	-0.004
forown	-0.082	0.017	-4.84	0.000	-0.115	-0.048
ownc	0.200	0.041	4.80	0.000	0.118	0.282
exed*cflo	3.853	2.223	1.73	0.083	-0.502	8.209
nexed*cflo	-0.672	1.050	-0.64	0.522	-2.731	1.386
instow*cflo	0.150	0.122	1.23	0.219	-0.089	0.390
LogTA	0.000	0.000	1.48	0.138	-0.000	0.002
Cflo	-0.017	0.023	-0.72	0.473	-0.062	0.029

Source: Computed from the Annual Report and Account using Stata Software

4.5.2 Hausman Test

The study performs Hausman specification test to make appropriate choice between fixed effect model (FEM) and Random effect model (REM).

Table 4.6: Hausman Test

Variables	fe (b)	Re (B)	Difference (b-B)	S. E.
exed	1.063	1.024	0.039	0.111
nexed	-0.354	-0.324	-0.030	0.050
instow	-0.043	-0.052	0.008	0.009
forown	-0.082	-0.082	-0.000	0.007
ownc	0.194	0.200	-0.016	0.111
exed*cflo	5.509	3.853	-0.344	0.916
nexed*cflo	-0.582	-0.672	0.090	0.394
instow*cflo	0.151	0.150	0.000	0.051
LogTA	0.001	0.000	0.000	0.000
Cflo	-0.017	-0.016	-0.000	0.006

Source: Computed from the Annual Report and Account using Stata Software

H_0 : differences in coefficients not systematic

Chi2 5.33

Probability > chi2 = 0.8049

Accordingly, the result from hausman specification test shows a chi2 of 5.33 and p value of 0.8049. The p value with 0.8049 shows insignificant difference in the estimated coefficient of the two model which violates the assumption of fixed effect approach. Therefore, the study fails to reject the (H_0) which state that random effect is more appropriate. Furthermore, since the result favours random effect, there is need to further conduct a test for panel effect of the data using Breusch and Pagan Lagrangian multipliers test for random effect and OLS.

4.5.3 Lagrangian Multiplier Test for Random effect

The Lagrangian multiplier test is conducted to test the hypothesis that there is no random effects ie the random effect is zero. This test assist the study to interpret the appropriate result between random effect and ordinary least square.

Table 4.7: Breush and Pagan Langrangian Multiplier Test

	Var	Sd=sqrt(var)
Dllp	0.000	0.025
E	0.000	0.018
U	0.000	0.004

Source: Computed from the Annual Report and Account (Stata Software)

Chi2 0.30 P value 0.2912

From table 4.8, the Lagrangian multiplier test with chi2 of 0.30 and P value of 0.2912 signifies that there is no panel effect on the data. The study therefore concludes that the generalized least square is the most appropriate technique of analysis.

4.6 Test of Hypotheses

The hypotheses is subject to test using robust ordinary least square and the decision rule is to reject the null hypotheses (Ho) at 1%, 5% and 10% significant level.

Model for Hypotheses Testing

$$dllp = \alpha_0 + \beta_1 exed_{it} + \beta_2 nexed_{it} + \beta_3 ownco_{it} + \beta_4 instow_{it} + \beta_5 forown_{it} + \beta_6 cflo + \beta_7 exed * cflo_{it} + \beta_8 nexed * cflo_{it} + \beta_9 instow * cflo_{it} + \beta_{10} \log TA + e_{it}$$

Table 4.8: Robust Ordinary Least Square

Prob F 0.0000

R Square 0.4487

Dllp	Coef.	Robust Std. Err	T	p>/t /	95% Conf.	Interval
exed	1.011	0.332	3.05	0.003	0.354	1.668
nexed	-0.313	0.159	-1.97	0.051	-0.627	0.001
instow	-0.056	0.026	-2.13	0.035	-0.108	-0.003
forown	-0.824	0.023	-3.56	0.001	-0.128	-0.037
ownc	0.204	0.065	3.11	0.002	0.074	0.332
exed*cflo	3.978	1.94	2.05	0.042	0.137	7.818
nexed*cflo	-0.708	1.000	-0.71	0.480	-2.688	1.272
instow*cflo	0.150	0.141	1.06	0.289	-0.129	0.430
logTA	0.000	0.000	1.58	0.116	-0.000	0.001
cflo	-0.016	0.023	-0.69	0.491	-0.063	0.030
constant	0.052	0.0125	4.16	0.000	0.027	0.077

Source: Computed from the Annual Report and Account using Stata 13 Output

The table 4.9 is the summary of the estimated regression model. The Prob F of 0.0000 which is significant and adjusted R of 0.46 signifies the fitness of the model. The regression equation is therefore:

$$dllp = 0.05 + 1.01exed_{it} - 0.3nixed_{it} + 0.2ownco_{it} - 0.05instow_{it} - 0.82forown_{it} - 0.02cflo + 3.9exed*cflo_{it} - 0.7nixed*cflo_{it} + 0.2instow*cflo_{it} - 0.00006 \log TA + e_{it}$$

4.6.1 Executive Director Ownership and Earnings Management

The study examines the significant effect of executive director ownership on the earnings management. From table 4.9, the executive director ownership (exed) has a coefficient of 1.01, a standard error of 0.33 and t- value of 3.05 with a probability value of 0.003 which is significant at 5% level. The study therefore rejects the null hypothesis (Ho) which state that executive director ownership has no significant effect on the earnings management of listed DMBs in Nigeria. The result indicates a positive and significant relationship between executive director ownership and earnings management. The result signifies that executive directors engage in earnings management in DMBs.

4.6.2 Non – Executive Director Ownership and Earnings Management

The effect of non- executive director ownership on the earnings management is tested and the findings from table 4.9 shows that the non – executive directors ownership (nixed) has a negative coefficient value of 0.31, a standard deviation of 0.159 and t-value of -1.97 with probability value of 0.051 which is significant at 10%. The study therefore rejects the null hypothesis (Ho) which state that non- executive director ownership has no significant effect on the earnings management. This result provides an evidence that non- executive director ownership has inverse and significant effect on earnings management. The coefficient value of -0.31 signifies that an increase in non – executive director holdings by 1% lead to a fall in earnings management by 31%. The findings is in agreement with the

agency theory which suggests that non – executive director have an important monitoring function of financial reporting process.

4.6.3 Institutional Ownership and Earnings Management

The institutional ownership is tested to examine its effect on the earnings management and the findings from the hypothesis shows a negative coefficient value of 0.056, a robust standard error of 0.026 and t – value of -2.13 with probability value of 0.035 which is significant at 5%. The result shows that the institutional ownership has a negative and significant effect on earnings management. The findings therefore reject the null hypothesis (H₀) which state that institutional ownership has insignificant effect on the earnings management. It also signifies that an increase in institutional ownership by 1% lead to a fall in earnings management by 5.6%.

4.6.4 Foreign ownership and Earnings Management

The effect of foreign ownership on the earnings management is tested and the findings from table 4.9 shows that foreign ownership has a negative coefficient of 0.082, a robust standard error of 0.023 and t- value of -3.56with probability value of 0.001which is significant at 1%. The result indicates that foreign ownership has an inverse and significant effect on earnings management. The study therefore rejects the null (H₀) which state that foreign ownership has no significant effect on the earnings management. The result reveals that foreign investors deploy their skills and technology in monitoring the activities of the managers.

4.6.5 Ownership Concentration and Earnings Management

The effect of ownership concentration on earnings management is examined and the result from table 4.9 shows that ownership concentration with a coefficient of 0.204, a robust standard error of 0.065, t- value of 3.11 with probability value of 0.002 is significant at 1%.

The findings reveal that ownership concentration has a positive and significant effect on the earnings management. The study therefore rejects the null (H_0) which state that ownership concentration has no significant effect on the earnings management. The implication of the coefficient value of 0.07 signifies that an increase in ownership concentration by 1% lead to a rise in accounting manipulation by 6.5%. This result signifies that the higher the concentration of the shareholding, the higher the earnings management.

4.6.6 Free Cash flow and Earnings Management

The relationship between free cash flow and earnings management is tested and the result from the hypothesis test in table 4.9 shows a negative coefficient value of 0.016 a robust standard error of 0.024, t- value of -0.69 with probability value of 0.49 is insignificant at 10%. This result indicates that free cash flow has a negative and insignificant effect on the earnings management. It therefore fails to reject the null hypothesis which state that free cash flow has no significant effect on the earnings management in DMBs listed on Nigeria Stock Exchange. The result signifies that free cash flow is negative because it moderates the relationship between ownership structure and earnings management. This is due to the fact that managers would have used the surplus funds to pay out dividend. If such is done, it will cushion the effect of illiquidity on the earnings management.

4.6.7 Free Cash flow Moderating Effect on the Executive Director Ownership and Earnings Management

The moderation effect of free cash flow on the relationship between executive director ownership and earnings management is assessed and the result from table 4.9 on the interaction between free cash-flows and executive director ($cflo*exed$) shows a coefficient value of 3.97 a robust standard error of 1.94, t- value of 2.05 with probability value of 0.042 which is significant at 5%. The result indicates that free cash flow has a significant positive moderating role on the relationship between executive director ownership and

earnings management. The study therefore rejects the null hypothesis which states that free cash flow has no significant moderating role on the relationship between director ownership and earnings management.

4.6.8 Free Cash flow Moderating Effect on Non – Executive Director Ownership and Earnings Management

The moderation effect of free cash flow on the relationship between non- executive director ownership and earnings management is tested and the result from table 4.9 on the interaction between free cash-flows and non - executive director (cflo*nexed) shows a negative coefficient of variation of 0.708 with t value of -0.71 and the p value of 0.480 which is not significant at 10%. The findings provides an inverse and insignificant moderating role on the relationship between non - executive director ownership and earnings management. The study therefore fails to reject the null hypothesis which state that free cash flow has no significant moderation role on the relationship between non - executive director ownership and earnings management.

4.6.9 Free Cash flow Moderating Effect on the Institutional Ownership and Earnings Management

The moderating effect of free cash flow on the relationship between institutional ownership and earnings management is examined and the result from table 4.9 on the interaction between free cash-flows and institutional ownership (cflo*instow) provides the coefficient of variation of 0.15, robust standard error of 0.14 with t value of 1.06 and the p value of 0.289 which is not significant at 10%. The findings reveal a positive and insignificant moderating role on the relationship between institutional ownership and earnings management. The study therefore reject the null hypothesis which state that free cash flow has no significant moderation role on the relationship between institutional ownership and earnings management.

The summary of hypotheses test is as presented in the table 4.9 below:

Table 4.9: Summary of Test of Hypotheses

Variable	Reported Sign	Significance	Remarks
Executive Director Ownership	+	1%	Rejected
Non – Executive Director Ownership	-	10%	Rejected
Institutional Ownership	-	5%	Rejected
Foreign Ownership	-	1%	Rejected
Ownership Concentration	+	1%	Rejected
Free cash flow	-	10%	Accepted
Executive Director ownership and free cash flow interaction	+	5%	Rejected
Non - executive director and free cash flow interaction	-	10%	Accepted
Institutional Ownership and free cash flow interaction	+	10%	Accepted

Source: Computed from the Annual Report and Account using Stata Software

4.7 Test for Moderation Effect

The study compares the R squared of the direct relationship in appendix XI with the R squared after the interaction of free cash flow (Moderating variable) and the following changes is revealed. The regression of the ownership structure in the direct relationship shows R squared of 0.44 but after the interaction of the moderating variable, the R square increases from the earlier position of 0.44 to 0.46. The improvement in the R squared signifies an increase in the prediction power of the moderating variable in the model. Also the executive director ownership (exed) in the direct relationship has a coefficient value of 0.65 but after the interaction with free cash flow, the coefficient increased from (0.65 to 3.97). The improvement in the coefficient variation signifies that free cash flow plays moderating role in the relationship. The non - executive director ownership with negative coefficient variation of 0.13 in the direct relationship increased to a coefficient value of 0.71 after the interaction of free cash flow while the institution ownership in the direct relation has a negative coefficient value of 0.07 in the direct relationship but the coefficient of variation increase to 0.15 after

the interaction with free cash flow. Also, the result documents a change in sign in the relationship between institutional ownership and earnings management. The institutional ownership was negative in the direct relationship but after the interaction of free cash flow, the relationship between institutional ownership and earnings management become positive. However, the improvement in the R squared, coefficient of variation and change from negative to positive in the relationship signifies that the variable (free cash flow) strengthen the relationship between the executive director ownership, non- executive director ownership, institution ownership and earnings management.

Below is the regression summary for direct and moderation relationship of the ownership structure variables and earnings management.

Table 4.10: Summary of Direct and Moderation Regression of Ownership Structure Variables and Earnings Management

	Direct Relation	Interaction with Moderator
R ²	0.44	0.46
Coefficient value of exed	0.65	3.97
Coefficient value of nexed	0.13	0.71
Coefficient value of instow	0.07	0.15

Source: Computed from Annual Report and Accounts (Stata 13 Output)

4.8 Discussion of the Findings

The findings of the study on the effect of ownership structure and earnings management and the moderating free cash flow are discussed as follows.

4.8.1 Executive director ownership and earnings management

The result reveals that executive director ownership is significantly positive related to the earnings management. This implies that the executive directors in the banks manage reported earnings instead of providing monitoring mechanism to mitigate earnings manipulation. The findings is consistent with the study conducted by Koh(2003),Nedal, Bana and David (2010), (Yang, 2010), Reyna (2012) but contradicts the findings of Alves (2012). In comparing the findings to the prior studies in Nigeria, the study supports the result of

Elijah and Isenmila (2012) but contradicted the findings of Onoye & Eriki (2014). The difference in the findings may arise from different domains of the studies because the major studies are conducted in manufacturing firms and other industries outside DMBs.

The executive directors engaged in earnings management without considering the consequence of their act on their stake as well as stake of other shareholders. This means that the executive directors prefer to manipulate the reported earnings in order to benefit from the compensation plan. Because the higher the reported earnings the higher they are compensated. However, the findings do not support the agency theory and convergence hypothesis which state that insider will be seen as monitoring mechanism when they acquire some portion of the firm's equity, they will prevent managers' opportunistic behaviour and the magnitude of discretionary accruals is predicated to be inversely associated with the insider ownership, though the reason is not far from the insignificant stake they are holding in the bank. It however supported an argument of executive compensation plan. This plan attempts to align the interests of the owner and manager by providing them a compensation based on current reported earnings. The compensation plans of the executive directors serve as a stronger inclination to maximize current reporting earnings.

4.8.2 Non – executive director ownership and Earnings management

The non- executive director ownership and earnings management are significantly inverse related. The finding is in line with the argument of the agency theory which state that the non – executive director ownership provides monitoring mechanism to mitigate the activities of the managers against account manipulation. A good number of non-executive directors who have a stake in the banks may have adequate technical capacity and professional competence to restrain managers from engaging in earnings management. Since the non – executive directors do not have direct access to the accounting process and the only reward they have is the return on their investment, they tend to focus more attention on the

monitoring mechanism. The findings of this study is in agreement with the prior studies conducted by Byrel and Hickman (1992); Habbash, Salama and Dixon (2008); Dimilropous and Asteriou (2010) and Alves (2014)but contradict the study of Fich and Shivdasani (2006); Abdul Rahman and Ali (2006). However the study of Habbash, Salama and Dixon (2008); Alves (2014), conclude that boards of directors with more non-executive directors have tendencies for increasing the monitoring mechanism and they are expected to emphasis on better earnings management that improves the integrity of financial reporting. He further argues that boards of directors are the primary element of corporate governance, because they are responsible for monitoring the quality and integrity of financial information and also control top management as delegated by the shareholders.

4.8.3 Institutional ownership and earnings management

The institutional ownership and earnings management are significantly negative related in DMBs. The result of this study supports the findings of Vehuryand Jenkins (2006), Koh(2007), Mbogela and Swai (2016), Chung *et al.* (2005), Al –Zoubi and Salemat (2012), Hsu and Wang (2014) but contradict the work of Muhammed (2010), Alves (2012), Lin & Manowan (2012). The contradicting evidences may be that the institutional ownership in Nigeria DMBs are for long term while the institutional ownership in the industry of their studies are short term institutional ownership. The result supports the argument of the agency theory that the presence of long term institutional investors reduces agency problem because they play active role in constraining the opportunistic earnings manipulation. It agreed with the argument that long term institutional investors provide monitoring mechanism to constrain accruals management.

4.8.4 Foreign Ownership and Earnings Management

The result indicates that foreign ownership hassignificant inverse effect on earnings management. The outcomes is consistent with the studies conducted by Ahmed and Iwasaki

(2015); Guo *et al.* (2015) but contradict the evidences in the studies conducted by Aharony, Lee and Wong as cited in Idris 2012: Ali, Salleh, and Hassan (2008), Idris (2012).

The outcome is predicated on the technical capability of the foreign investors to detect account manipulation and monitoring focus. Some of the foreign investors sees accounting manipulation as a crime and therefore will provides all necessary mechanism to inhibit managers from engaging in such act. The position of this study validates the view of agency theory which state that foreign ownership deploy their expert to provide monitoring mechanism to reduce earnings management. It also agreed with the position of the knowledge spill over hypothesis which predicts that the superior knowledge of foreign investors can curtail earnings management. The foreign investors can be seen as effective mechanism that could complement the governance structure to monitor the management from non – value maximum activities. However, the study disagree with information asymmetry hypothesis which predict that the distance makes it difficult for foreign investors to monitor a firm’s accounting department and curtail earnings manipulation.

4.8.5 Ownership Concentration and Earnings Management

The findings from the test on the effect of ownership structure on the earnings management reveals a significant positive effect. The result supports the work done by Leuz, Nanda and Wysocki (2003), Hu and Izumida (2008); Reyna (2012); Vicent, Laetitia and frank (2014) but contradicts the studies conducted by Marcia et’ al (2006); Alves (2012) and Usman and Yero (2012). It is also in line with the argument of the agency theory that firms with concentrated ownership may have influence over the business and want to increase the conflict of interest between the managers and shareholders. It therefore disagree with the evidences from the studies of Alves (2012) that ownership concentration provides monitoring mechanism to curtail earnings management. This is because the ownership concentration

which is a block- holding of 5% above have the category of the shareholders whose holding is concentrated. The shareholders in this category have monumental influences on the bank. Many of them are on the board directly and some of them nominates their representatives into the management level. Accordingly, the people on the board or those in the management level have direct influences on the accounting process thereby engage in the accounting manipulation to suite their demand. The earnings management may be upward or downward as the case may be. They may manipulate earnings management downward in order to reduce the political cost. Also, managers engage in upward earnings management to manipulate the share prices upward. Ownership concentration unless it is diluted to be disperse, earnings management tend to be on the rise.

4.8.6 Free Cash flow and Earnings Management

The result indicates that free cash flow has a negative and insignificant effect on the earnings management after interaction with executive director ownership, non- executive director ownership and institutional ownership. The result signifies that the presence of free cash flow reduces the consequence of reported earnings by DMBs in Nigeria. The result has confirmed why banks in Nigeria after declaring dividends sometimes experience liquidity problem. The presence of free cashflow therefore affect the workability of ownership structure. It however justifies that the free cash flow use in the study is capable of presenting a true picture of the relationship between ownership structure and earnings management which has been mixed. The findings is in disagreement with the work of Chung *et al.* (2005); Jaggi and Gul (2000); Bukit and Iskandar (2009); Rusmin, *et al.* (2014) but in agreement with Redwhan and Ku (2011); Nekhili (2015).

4.8.7 Executive director ownership, free cash flow Interaction and Earnings Management

The findings on the interaction of the free cash flow and executive director ownership on earnings management shows that free cash flow has a positive and significant moderating role on the relationship between executive director ownership and earnings management. The study contradicts the findings of Jensen (1989), Chung *et al.* (2005), Pinando and Torre (2009); Bukit and Iskandar (2009); Rusmin *et al.* (2014) which conclude that the existence of a substantial level of free cash flow motivates managers to opt for sub-optimal investment policies and conceal their projects counter-performance in a low growth opportunity firms. The disagreement is as a result of using free cash flow in a direct relationship with earnings management in the absence of corporate governance such as insider holders to monitor the utilization of funds. However, the existence of free cash flow is capable of reducing earnings management. The empirical evidence has shown that the availability of free cash flow or surplus funds after investing in good projects is capable of reducing earnings management engaged by the executive director who interface with the accounting process. This is because when such funds support the firm's reported earnings it could be paid out as dividends to the shareholders thereby reducing pressures from them. Dividend payment is one of the motivations for earnings management. The empirical findings support the argument of the code of corporate governance that if the holding of the executive director increases, the motivation to engage in opportunistic accounting reduces.

4.8.8 Non - Executive director ownership, free cash flow Interaction and Earnings Management

The findings on the interaction of free cash flow and non-executive director ownership on earnings management provides an inverse and insignificant moderating role on the relationship between non-executive director ownership and earnings management. Although the finding reveals an insignificant relationship but the negative sign and improvement

in the coefficient shows a moderating role of free cash flow on the relationship between non-executive director ownership and earnings management. Where there is excess or surplus funds after investing in the viable project, the funds is distributed to the shareholders in form of dividend thereby reduces earnings management. This is because the managers will not be under pressure to engage in earnings manipulation. The study therefore conclude that free cash flow reduces the conflict between managers and shareholders if the non-executive director provide monitoring mechanism to the system.

4.8.9 Institutional ownership, free cash flow Interaction and Earnings Management

The findings on the interaction of free cash flow and institutional ownership on the earnings management reveals a positive and insignificant effect on the relationship between institutional ownership and earnings management. This implies that institutional investors are not interested in the monitoring mechanism rather they focus on short term earnings. However, the result provides support to the findings of (Claessens and fan 2002) as cited in (Kazemian and Senusi 2015) that institutional investors do not play an active role in monitoring management activities (Claessens and Fan, 2002) as cited in (Kazemian and Senusi 2015). It also agreed with the work of Duggal and Millar (1990) as cited in (Kazemian and Senusi (2015) that institutional investors are passive investors who are more likely to sell their holdings in poorly performing firms than to expend their resources in monitoring and improving their performance. Institutional investors may be incapable of exerting their monitoring role and vote against managers because it may affect their business relationships with the firm. The findings therefor provides a clearer picture on the mixed findings in the relationship between institutional ownership and earnings management. Because the findings still support the prior result that short term investors are not interested in providing monitoring mechanism rather they are only focusing on the firm that is reporting good performance despite the omission of a key moderating variable (free cash flow).

4.9 Implications of the Findings

The findings of this study has both theoretical and managerial implications. The theoretical implication explains the contribution of this study to the body of knowledge in the academic and external environment while the managerial implication elucidate the important of the findings to the regulatory and business environment.

4.9.1 Theoretical Implication of the Findings

The findings of this study contribute to the body of knowledge by establishing a positive relationship between executive director ownership and earnings management in deposit money banks in Nigeria as against the inverse relationship expected in the case of manufacturing and other non – financial institutions. This result has established that the executive directors in the banking industry do not behave the same as executive directors in manufacturing and non- financial institutions. The findings show that the executive directors in the DMBs do not provide monitoring mechanism against the managers’ unethical behaviour to curtail earnings management while those in the manufacturing and other non - financial institutions monitor the accounting process to reduce earnings management (Alves 2012; Isemla 2012 and Onoye & Eriki 2014). This might be as a result of low stake given to the executive directors of banks in Nigeria.

Similarly, this study provides the first evidence of the interaction between executive director ownership and free cash flow on the earnings management. The prior studies only focus on the specific accruals which is discretionary loan loss provision in the banking industry as the major factor influencing earnings management. But this study has provided further evidence that free cash flow reduces the ability of the manager to manipulate earnings if the funds available after financing viable projects is properly utilized or paid out to the shareholders in form of dividends. The study extend the body of knowledge on the interaction between executive director and free cash flow in the banking industry.

The study also contributes to the body of knowledge by providing further evidence to validate the agency theory and code of corporate governance which encourage non- executive directors to have more holding to mitigate against the activities of managers vis – a vis earnings management. It also uphold the empirical findings of the prior studies which state that non – executive director ownership provides monitoring mechanism to curtail earnings manipulations. This findings extend the body of knowledge by confirming that non- executive directors in both banking industry and non – financial institutions such as manufacturing firms behave in the same way by providing monitoring mechanism against accounting manipulations. It also disagree with the premise that non – executive directors are too busy with other commitment and do not have time to provide proper monitoring because there are only involve on part - time basis. More so, the study provides evidence that the interaction of non – executive directors’ ownership and free cash flow inhibit earnings management. The study extend the body of knowledge by taken executive director ownership, non- executive director ownership separately which is different from the prior studies that used managerial ownership.

The findings of this study offers an insight to the controversy of mixed findings on the relationship between institutional ownership and earnings management. Because, it helps the existing literature to explain the relationship between institutional ownership and earnings management. In the existing literature, the relationship between institutional ownership and earnings management can be either ways, that is the relationship may be positive or negative it depends on whether the institutional ownership is long term or short term. If the institutional ownership is long term or stable, they is tendency that they provide monitoring mechanism to mitigate the activities of managers which might affect their long term investment. On the contrary, the short term institutional ownership consider monitoring cost as a waste because they are not willing to remain there for a long time. However, this study

provide an evidence that institutional ownership in Nigeria DMBs are short term because they fail to monitor the activities of the managers. The findings is further validated by the interaction between institutional ownership and free cash flow which produce evidence that even when bank have free cash flow which serve as an incentive to manipulate earnings, the institutional ownership in the DMBs shows indifference in monitoring them.

The study is one of the few works that have contributed to the dearth of literature on the relationship between foreign ownership and earnings management in the DMBs of emerging market like Nigeria. A few studies in Nigeria focus on the relationship between foreign ownership and earnings management in manufacturing firms with limited studies in the area of DMBs. This may be as a result of paucity of data on foreign ownership in Nigeria. However, with the reverse code of corporate governance (2006) in the bank, this data is now available and adequate for studies.

Also, the study extend the body of knowledge on the relationship between ownership concentration and earnings management. The existing literature in Nigeria focus more on the manufacturing firms, food and beverages and others with limited literature in the area of banking industry in Nigeria. There are literature on ownership concentration but most of this literature are in developed economies and not emerging economy like Nigeria.

Finally, the variables cover in this studies and the introduction of free cash flow as a moderator on the relationship between ownership structure and earnings management make this study unique, original and a relevant research literature to other researchers.

4.9.2 Managerial Implication of the Findings

.The findings of this study is important to regulators such as Central Bank of Nigeria (CBN) and Security and Exchange Commission (SEC) in the amendment of code of corporate governance in Nigeria banking industry.

The findings expose the activities of the executive director in the manipulation of earnings which is linked to the low stake by the executive director in Nigeria DMBs. The result also assist CBN not to supervise only the prudential guidelines, capital adequacy ratio, cash reserve ratio, Deposit money banks returns but extend the search light to the area of free cash flow usage in share repurchase, investment decision and dividend payment. Similarly, the study also expose the deficiency of the prudential guidelines regarding general loan loss provisions, quality of credit assets, loan charge off and bad debt recovered to include in the subsequent review to curtail accounting manipulations.

The findings is vital to the potential investors and analyst in making investment decisions. Because, one of the motivations for earnings management is the manipulation of share prices to attract the potential investors through the presentation of streams of earnings growth. The analyst should extend the evaluation of banks' annual report beyond financial statements to the area of non - financial statements (ownership structure). By doing that, the analyst would offer a good advice to potential investor in making investment decision in the banks with more non- executive directors on the board, since they provide monitoring mechanism to restrain earnings management.

Similarly, the result of this study offers an insight to the monitoring determination of the foreign investors and assist Security and Exchange Commission (SEC) to facilitate the establishment of policies that foster cross - border listing. This is to bring on board the foreign investors especially those from the countries that have laws against accounting manipulations. It provides further evidence on the possibility of coexistence of the opportunistic and informative foreign ownership in addition to non – executive director ownership and their inverse associations with earnings management. Understanding the nature of these associations is important for portfolio managers and decisions makers because they may convey information about the quality of financial information and firm's value.

The empirical evidence also provide shareholders with an insight on the importance of non – executive director ownership, foreign ownership in the holding mix of the banks and the implication of free cash flow regarding the investment decision, dividend payment and share repurchase.

Finally, the empirical evidence provides in this study is sufficient to assist the academicians in the course of research work, regulators and government to amend the code of corporate governance and provide a legal environment to improve the quality of reported earnings.

4.9.3 Policy implication of the Findings

The executive director in DMBs engage in earnings manipulation despite the introduction of ownership structure in the corporate governance. The ownership structure encourages the executive directors to hold shares up to 5% in Nigeria banks. This is because, the substantial holdings of the executive directors encourage them to provide monitoring mechanism and improve the quality of the financial reporting. However, this governance is far from solving the problem of earnings management by the executive directors in DMBs.

The article 3.3.1 code of corporate governance (2017) provides that an equity holding of 5% and above by any investor shall be subject to CBN' prior approval. However, the policy fails to state clearly how the influence of the investors' holdings 5% and above could be curtailed to reduce earnings management. The findings from this study reveals the influence of ownership concentration on the earnings management. It is therefore important to fill the policy gap by stating clearly how the influence of the majority shareholders could be curtailed to avoid account manipulation and appropriation of the minority shareholders.

Also, the article 3.3.2 which state that the board shall ensure that minority shareholders are adequately protected from over-bearing influence of the controlling

shareholders. This section is far from providing protection to the minority shareholders because the people on the board are under the dictate of the controlling shareholders.

The article 5.5.2 states that the board shall constitute only executive directors and non- executive directors and the chairman of each board shall be a non – executive director. Although, it specifies that the number of non- executive director on the board shall be more than that of executive director. The findings from this study reveals that the executive directors in the bank engage in account manipulation. Only the non- executive directors provides monitoring mechanism to mitigate the unethical behaviour of the managers. However, the code of corporate governance did not include the present of foreign investors on the board. The findings from this study reveals that foreign investors provides technical capacities to monitor the activities of the managers. The need to categorically state the presence of the foreign investors on the board cannot be emphasised.

Also, the issue of technical competence needs to be accentuated. The non- executive directors on the board needs to be technically sound to analyse the financial statements. The findings from the study reveal that the non – executive directors could not monitor the activities of the managers when there is availability of surplus funds. This is because the monitoring capacity of the non- executive directors become insignificant when there is interaction of free cash flow. It shows the inability of the non- executive director to monitor the utilization of free cash flow in the banking sector.

4.10 Summary

The statement of hypotheses is tested in this chapter. The study describes the behaviour of the data using descriptive statistics while inferential statistics is used to draw conclusion from the data tested. The inferential statistical instruments use is correlation matrix, variance inflation factor (VIF) and robustness tests. OLS multiple regression is used for analysis after running all the necessary test to avoid bias in the estimation. All

regressions were run based on heteroscedasticity corrected standard errors and the robust ordinary least square is interpreted. The results of the study signifies that the executive directive ownership and non- executive director ownership do not behave in the same way in Nigeria DMBs. while the executive director ownership influences accounting manipulation process in the bank, the non – executive director ownership provides monitoring mechanism to mitigate earnings manipulation. Similarly, the free cash flow has a significant moderating effect on the relationship between executive director ownership, institutional ownership and earnings management. In the light of this, six hypotheses formulated is rejected while the remaining three (3) hypotheses formulated is accepted.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The role of ownership structure in curbing the accounting manipulation by the managers has become topical issue in the mind of researchers, academicians and regulators. This is because despite the revised corporate governance in 2006 DMBs in Nigeria are yet to come out of the challenges. In the last ten (10) years, some banks losses their identities, while others are liquidated or taken over by Assets Management Corporation of Nigeria (AMCON) and part of the faults are attributed to the poor ownership structure. In an attempt to resolve the problem, the study examine the workability of the ownership structure in curbing account manipulation. It also extend the study by assessing the interaction of other factor such as free cash flow. This is done by examining the moderating role of free cash flow on the relationship between ownership structure and earnings management.

To provide answers to the questions raised, the study uses independent variables that is, executive director ownership, non- executive director ownership, institutional ownership, ownership concentration, foreign ownership to capture ownership structure, free cash flow as a moderator, firm size for control variable and earnings management as dependant variable.

Using robust ordinary least square, the study tests the hypotheses formulated from the questions and provides evidence that ownership structure has effect on earnings management and free cash flow moderating the relationship between ownership structure and earnings management. Specifically, the executive director ownership, institutional ownership, ownership concentration are positively related to the earnings management while the non – executive director ownership and foreign ownership are inversely related to the earnings management. The free cash flow and firm size are insignificant, there are negatively and positively related to earnings management respectively. The free cash flow moderating effect on the relationship between executive directors ownership, institutional ownership are

positive and significant while the moderating role of the free cash flow on the relationship between non- executive directors' ownership and earnings management is inverse and insignificant. The findings are relevant to the users of accounting information.

5.2 Conclusion

The study investigates the effect of ownership structure on earnings management and the moderating role of free cash flow of listed DMBs in Nigeria. From the findings of this study, the following conclusions are made;

The study concludes that the executive directors in the banks engage in the manipulation of reported earnings instead of providing monitoring mechanism to mitigate earnings manipulation.

On the contrary, the study provides an evidence that the non- executive director ownership has an inverse and significant effect on the earnings management. It therefore concludes that non- executive director ownership provides monitoring mechanism and reduces agency conflict with respect to reported earnings of listed DMBs in Nigeria.

The study also concludes that the institutional ownership has a positive and insignificant effect on earnings management. The result supports the argument that the presence of institutional investors increases agency problem because they do not play active role in constraining the opportunistic earnings manipulation. It therefore conclude that institutional investors are inherently short-term oriented and myopic who focus mainly on current earnings rather than long-term earnings.

The findings provides an evidence that foreign ownership has an inverse and significant effect on earnings management. Accordingly, the presence of foreign investors in the ownership structure mitigate the opportunistic accounting behaviour of the managers and improve the quality of financial reporting. The findings also supports the knowledge spill

over hypothesis and the position of the agency theory on the foreign ownership but contradicts the view of information asymmetry hypothesis. The result validate the agency theory which postulate the existence of conflict between shareholders and managers and the argument of executive compensation plan which the reward is based on the reported earnings. This agency contract between the firm and managers provide incentive for earnings manipulation. The findings on the executive director ownership however contradicted the convergence of interest hypothesis and alignment effect hypothesis which argue that the insider ownership can provide monitoring mechanism to constrain the opportunistic behavior of managers. This implies that the insider ownership such as executive director ownership in Nigeria DMBs do not provide monitoring mechanism to mitigate earnings management. Also, the result signifies that free cash flow has a negative and insignificant effect on the earnings management.

The moderating role of free cash flow on the relationship between executive director ownership and earnings management of listed DMBs on the Nigeria Stock Exchange documents a positive and significant relationship. On the contrary, the interaction of free cash flow on the relationship between non- executive director and earnings management document an inverse and insignificant relationship. This implies that the quality of monitoring mechanism provide by the non – executive director ownership reduces as the banks uses free cash flow in their financial reporting.

Finally, the interaction of free cash flow on the relationship between institutional ownership and earnings management provides a positive and significant relationship. This implies that institutional ownership is indifferent on how the managers utilize free cash flow in the system.

5.3 Limitations of the Study

The findings of this work should be interpreted with caution as it is not free from the limitations stated hereunder:

- i. The findings of this study is only applicable to the DMBs which has its measurement from discretionary loan loss provision. The study does not consider Islamic bank, micro- finance banks and other banks operating in Nigeria.
- ii. The study only consider the quantitative factor which influence earning management. The study might have excluded some qualitative factors which play important role in account manipulation.
- iii. Mergers and acquisitions that took place in Nigeria DMBs such as Oceanic bank, Intercontinental bank, Afri- bank, bank PHB might affect the data used.
- iv. The methodology used in the study is not perfect as measurement error might occurs during the applications.

5.4 Recommendations of the Study

In line with the findings of the study, the following are the recommendations;

- i. The executive director of DMBs that engage in earnings management should be discouraged by amending the code of corporate governance to include stringent penalty and punishment. The penalty shall include dismissal of such executive director.
- ii. The non- executive directors should be included in the accounting process such as preparation of management account by annual. The inclusion of non- executive directors in the accounting process will provide more monitoring mechanism to check the activities of the managers in account manipulation.

- iii. Institutional shareholders should be mandated to keep their investment in a particular bank for a minimum period of five year. If such policy are made, the investor who keeps an investment in a firm for such period will pay more attention to wealth maximisation than reported earnings. This will give room for proper monitoring mechanism to be provided by the knowledgeable institutional shareholders. Because the institutional holders are only passive if their investment is for a short term.
- iv. Foreign investors should be encourage to be on the board of DMBs in Nigeria. This is because foreign investors provide monitoring mechanism to inhibit earnings management. SEC should also fast track the cross boarder listing to remove the bottleneck of investing in Nigeria DMBs listed on the Nigeria Stock Exchange by foreigners.
- v. Ownership concentration in the banking industry should be reduced by SEC to a maximum of 20% of the outstanding share capital to encourage disperse shareholding and reduce the influences of a few majority shareholders in the accounting manipulation. This is because a few major stakeholders in the bank influences managers to engage in earnings management.
- vi. The utilization of free cash flow source internally or externally in Nigeria DMBs should be regulated to discourage over- trading or over investment so as to avoid earnings management.

5.5 Areas for Future Studies

Further studies could be carried out in the following areas to addressing the inadequacies of this study by:

- i. Examine the approaches and critique in the measurement of earnings management in banking, manufacturing, insurance and derivative industries.
- ii. Assess the divergence between control right and cash flow right in ownership structure and earnings management.
- iii. Evaluate the expropriation of minority interest by the controlling family in agency problem.
- iv. Family ownership by Pyramid or cross - shareholdings and agency cost.

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Appendix I

Listed Banks as at December, 31st 2015

S/N	Deposit Money Banks (DMB)
1	Access bank
2	Diamond
3	Fidelity bank
4	First bank
5	FCMB
6	Guarantee Trust bank
7	Skye bank
8	Stanbic IBTC
9	Sterling bank
10	Union bank
11	UBA
12	Unity
13	Wema bank
14	Zenith bank

Source: NSE Official daily Listing, 2016

Appendix II

SUMMARY OF THE VARIABLES USED FOR THE ANALYSIS

Dllp	Discretionary loan loss provision
Exed	Executive director ownership
Nexed	Non – executive director ownership
Instow	Institutional ownership
Forown	Foreign ownership
Ownc	Ownership concentration
exed *cfl	Interaction of executive director and Free cash flow
nexed *cfl	Interaction of non-executive director and Free cash flow
instow *cfl	Interaction of institutional ownership and free cash flow
Cfl	Free cashflows
logTA	Firm size

Appendix III

. reg llp bbla lco cnpl lg

Source	SS	df	MS	Number of obs =	126
Model	.122132616	4	.030533154	F(4, 121) =	67.96
Residual	.054361764	121	.000449271	Prob > F =	0.0000
				R-squared =	0.6920
				Adj R-squared =	0.6818
Total	.176494381	125	.001411955	Root MSE =	.0212

llp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
bbla	-.4672703	.0698095	-6.69	0.000	-.6054766	-.329064
lco	-.279632	.1287747	-2.17	0.032	-.5345755	-.0246884
cnpl	-.4837048	.0303677	-15.93	0.000	-.5438257	-.423584
lg	.005601	.023518	0.24	0.812	-.0409592	.0521611
_cons	-.0075503	.0032278	-2.34	0.021	-.0139407	-.00116

Appendix IV

Descriptive Statistics

```
. su dllp exed nexed instow forown ownc exedcflo nexedcflo instowcflo fsz cflo
```

Variable	Obs	Mean	Std. Dev.	Min	Max
dllp	140	.0700761	.024922	.000557	.135793
exed	140	.0093345	.0085868	.0000272	.0586709
nexed	140	.0260781	.0165841	.0000116	.083009
instow	140	.0968121	.1070798	.004684	.605623
forown	140	.1851011	.1138902	.0156006	.8608934
ownc	140	.1132104	.0417058	.001928	.255824
exedcflo	140	.0002199	.0015743	-.0106916	.0087501
nexedcflo	140	.0010705	.0045439	-.0125099	.0272348
instowcflo	140	.0053218	.0309562	-.1855736	.1787774
fsz	140	17.65954	3.028084	10.1658	21.5192
cflo	140	.0252435	.1387102	-.52318	.410895

APPENDIX V

Correlation Matrix

```
. correlate dllp exed nexed instow forown ownc exedcflo nexedcflo instowcflo fsz cflo
(obs=140)
```

	dllp	exed	nexed	instow	forown	ownc	exedcflo	nexedc~o	
dllp	1.0000								
exed	0.2935	1.0000							
nexed	0.0539	0.5269	1.0000						
instow	-0.2446	-0.2037	0.3603	1.0000					
forown	-0.3380	-0.0420	-0.1466	-0.3893	1.0000				
ownc	0.4520	0.1087	0.2091	0.0566	-0.2616	1.0000			
exedcflo	0.1461	-0.0520	0.2950	0.0285	-0.0669	0.1095	1.0000		
nexedcflo	0.0831	0.0907	0.3956	0.3285	-0.2446	0.0871	0.6334	1.0000	
instowcflo	-0.0027	-0.0871	0.2454	0.3177	-0.2036	0.0222	0.2587	0.7905	
fsz	0.1431	-0.0586	-0.0971	-0.3201	0.2787	0.1553	0.1317	-0.1311	
cflo	0.0634	0.0057	0.2310	0.1997	-0.1706	0.0303	0.6608	0.8181	
	instow~o	fsz	cflo						
instowcflo	1.0000								
fsz	-0.1932	1.0000							
cflo	0.6690	-0.1219	1.0000						

APPENDIX VI

OLS Regression

```
. regress dllp exed nexed instow forown ownc exedcflo nexedcflo instowcflo fsz cflo
```

Source	SS	df	MS	Number of obs =	140
Model	.04008176	10	.004008176	F(10, 129) =	11.18
Residual	.046251796	129	.000358541	Prob > F =	0.0000
				R-squared =	0.4643
				Adj R-squared =	0.4227
Total	.086333555	139	.000621105	Root MSE =	.01894

dllp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
exed	1.011348	.3341074	3.03	0.003	.3503086	1.672388
nexed	-.3129808	.1728633	-1.81	0.073	-.654995	.0290334
instow	-.0559854	.0242191	-2.31	0.022	-.1039034	-.0080673
forown	-.082448	.0167601	-4.92	0.000	-.1156082	-.0492878
ownc	.2035409	.0421462	4.83	0.000	.1201537	.2869281
exedcflo	3.977723	2.204153	1.80	0.073	-.3832487	8.338694
nexedcflo	-.7082149	1.0473	-0.68	0.500	-2.780323	1.363893
instowcflo	.1504246	.1211391	1.24	0.217	-.0892521	.3901013
fsz	.0007686	.0006077	1.26	0.208	-.0004338	.001971
cflo	-.0163511	.0233252	-0.70	0.485	-.0625005	.0297983
_cons	.0523592	.0120059	4.36	0.000	.0286053	.0761131

APPENDIX VII

Multicollinearity Test

```
. vif
```

Variable	VIF	1/VIF
nexedcflo	8.78	0.113899
instowcflo	5.45	0.183426
exedcflo	4.67	0.214234
cflo	4.06	0.246410
exed	3.19	0.313395
nexed	3.19	0.313858
instow	2.61	0.383525
forown	1.41	0.707947
fsz	1.31	0.761670
ownc	1.20	0.834861
Mean VIF	3.59	

Heteroskedasticity Test

```
. hetttest
```

```
Breusch-Pagan / Cook-Weisberg test for heteroskedasticity  
Ho: Constant variance  
Variables: fitted values of dllp
```

```
chi2(1) = 3.57  
Prob > chi2 = 0.0588
```

```
. xtset id year
```

```
panel variable: id (strongly balanced)  
time variable: year, 2007 to 2016  
delta: 1 unit
```

APPENDIX VIII

Fixed Effect Regression

```
. xtreg dllp exed nexed instow forown ownc exedcflo nexedcflo instowcflo fsz cflo, fe
```

```
Fixed-effects (within) regression           Number of obs   =       140
Group variable: id                         Number of groups =        14

R-sq:  within = 0.4652                      Obs per group:  min =        10
        between = 0.4414                      avg =       10.0
        overall = 0.4605                      max =        10

                                           F(10,116)      =       10.09
corr(u_i, Xb) = 0.0467                      Prob > F       =       0.0000
```

dllp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
exed	1.063406	.3518996	3.02	0.003	.3664246	1.760388
nexed	-.3542263	.1792642	-1.98	0.051	-.7092816	.000829
instow	-.043715	.0260195	-1.68	0.096	-.09525	.0078199
forown	-.0816635	.0187391	-4.36	0.000	-.1187786	-.0445485
ownc	.1942824	.0432743	4.49	0.000	.1085722	.2799926
exedcflo	3.50932	2.404175	1.46	0.147	-1.252451	8.271092
nexedcflo	-.5817505	1.1217	-0.52	0.605	-2.803418	1.639917
instowcflo	.1508426	.132548	1.14	0.257	-.1116854	.4133706
fsz	.0012149	.0006314	1.92	0.057	-.0000356	.0024655
cflo	-.0170703	.024139	-0.71	0.481	-.0648806	.03074
_cons	.0447651	.0123449	3.63	0.000	.0203146	.0692157
sigma_u	.00689006					
sigma_e	.0186661					
rho	.1199125	(fraction of variance due to u_i)				

```
F test that all u_i=0:      F(13, 116) =      1.29      Prob > F = 0.2298
```

```
. est store fe
```

APPENDIX IX

Random Effect Regression

```
. xtreg dllp exed nexed instow forown ownc exedcflo nexedcflo instowcflo fsz cflo, re
```

```
Random-effects GLS regression           Number of obs   =       140
Group variable: id                     Number of groups =        14

R-sq:  within = 0.4634                 Obs per group:  min =        10
      between = 0.4953                   avg =       10.0
      overall  = 0.4640                   max =        10

Wald chi2(10)   =       111.56
corr(u_i, X)   = 0 (assumed)          Prob > chi2     =        0.0000
```

dllp	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
exed	1.023987	.3336569	3.07	0.002	.3700317	1.677943
nexed	-.32379	.172001	-1.88	0.060	-.6609057	.0133256
instow	-.0524673	.0243113	-2.16	0.031	-.1001165	-.004818
forown	-.0822589	.0170125	-4.84	0.000	-.1156029	-.0489149
ownc	.2006987	.0418182	4.80	0.000	.1187366	.2826608
exedcflo	3.853419	2.222612	1.73	0.083	-.5028208	8.20966
nexedcflo	-.6724405	1.050312	-0.64	0.522	-2.731015	1.386134
instowcflo	.1502068	.1222949	1.23	0.219	-.0894868	.3899003
fsz	.0008967	.0006049	1.48	0.138	-.0002888	.0020822
cflo	-.0166251	.0231903	-0.72	0.473	-.0620773	.028827
_cons	.0502031	.0119615	4.20	0.000	.0267589	.0736473
sigma_u	.0039682					
sigma_e	.0186661					
rho	.04323963	(fraction of variance due to u_i)				

```
. est store re
```

APPENDIX X

Hausman Test

```
. hausman fe re
```

Note: the rank of the differenced variance matrix (9) does not equal the number of coefficients being tested (10); be sure this is what you expect, or there may be problems computing the test. Examine the output of your estimators for anything unexpected and possibly consider scaling your variables so that the coefficients are on a similar scale.

	— Coefficients —		(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
	(b) fe	(B) re		
exed	1.063406	1.023987	.039419	.1118321
nexed	-.3542263	-.32379	-.0304362	.0505106
instow	-.043715	-.0524673	.0087522	.0092724
forown	-.0816635	-.0822589	.0005954	.0078565
ownc	.1942824	.2006987	-.0064163	.0111313
exedcflo	3.50932	3.853419	-.3440989	.9165434
nexedcflo	-.5817505	-.6724405	.09069	.3937697
instowcflo	.1508426	.1502068	.0006359	.0511169
fsz	.0012149	.0008967	.0003182	.0001811
cflo	-.0170703	-.0166251	-.0004452	.0067008

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(9) = (b-B)'[(V_b-V_B)^(-1)](b-B)
          = 5.33
Prob>chi2 = 0.8049
```

Appendix XI

Regression Analysis of Direct Relationship

. regress dllp exed nexed instow forown ownc fsz cflo, ro

Linear regression

Number of obs = 140
 F(7, 132) = 17.11
 Prob > F = 0.0000
 R-squared = 0.4487
 Root MSE = .01899

dllp	Coef.	Robust Std. Err.	t	P> t	[95% Conf. Interval]	
exed	.6588944	.2373373	2.78	0.006	.1894177	1.128371
nexed	-.1315796	.1269599	-1.04	0.302	-.3827188	.1195596
instow	-.0744639	.0247606	-3.01	0.003	-.1234428	-.025485
forown	-.0862306	.0231247	-3.73	0.000	-.1319736	-.0404877
ownc	.2036144	.0660942	3.08	0.003	.0728735	.3343554
fsz	.0009255	.000494	1.87	0.063	-.0000517	.0019027
cflo	.0148093	.0120097	1.23	0.220	-.008947	.0385656
_cons	.0507583	.0119537	4.25	0.000	.0271127	.0744039

APPENDIX XII

Regression Analysis

```
. regress dllp exed nexed instow forown ownc exedcflo nexedcflo instowcflo fsz cflo, ro
```

```
Linear regression                               Number of obs =    140
                                                F( 10,  129) =   13.59
                                                Prob > F       =  0.0000
                                                R-squared     =  0.4643
                                                Root MSE     =  .01894
```

dllp	Coef.	Robust Std. Err.	t	P> t	[95% Conf. Interval]	
exed	1.011348	.3320927	3.05	0.003	.3542948	1.668402
nexed	-.3129808	.1587178	-1.97	0.051	-.6270078	.0010462
instow	-.0559854	.0263336	-2.13	0.035	-.1080871	-.0038837
forown	-.082448	.0231913	-3.56	0.001	-.1283326	-.0365633
ownc	.2035409	.0653889	3.11	0.002	.0741673	.3329145
exedcflo	3.977723	1.941131	2.05	0.042	.1371473	7.818298
nexedcflo	-.7082149	1.000766	-0.71	0.480	-2.688254	1.271825
instowcflo	.1504246	.1414078	1.06	0.289	-.1293543	.4302035
fsz	.0007686	.000486	1.58	0.116	-.0001931	.0017302
cflo	-.0163511	.023692	-0.69	0.491	-.0632263	.0305242
_cons	.0523592	.0125754	4.16	0.000	.0274785	.0772399