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# Longitudinal Analysis of Corporate Governance Components and Earnings Management of Quoted Consumer Goods Companies in Nigeria

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**ABSTRACT**
The study longitudinally examined the impact of corporate governance components on earnings management of consumer goods industries in Nigeria covering a period of ten (10) years from 2005 to 2015. The longitudinal survey research design was used to examine how the predictor variable affects the criterion variable. Secondary data formed the source of data collection and relevant data were obtained from the annual publications of the twenty-seven (27) companies used were obtained from the Nigerian Stock Exchange for 2005- 2015 financial years. Multiple regression analysis using Ordinary Least Square was the statistical tool used with the aid of SPSS version 20. Findings revealed that board independence does have a significant impact on earnings management, board size does not have a significant influence on earnings management and audit committee meeting does not have a significant effect on earnings management. Based on the findings, it was recommended that audit committee as a component of corporate governance mechanism should meet more often as this will go a long way in curtailing earnings management and finally, we recommend that the corporate governance codes should be strengthened in such a way that the independence of the board will not be hampered.
**Keywords:** Board size; board independence; audit committee meeting; discretionary accrual; earnings management.

## INTRODUCTION
Over the years the veracity of financial reporting has given financial regulators, financial analyst, managers of corporate organizations and accounting practitioners a serious concern; principally sequel to the monumental accounting scandals and frauds concerning eminent firms such as One Tel in Australia, Nortel in Canada, Worldcom and Enron in United States of America, Parmalat in Italy, Transmile Group Berhad in Malaysia and also in Nigeria such as the cases of Oceanic Bank, Intercontinental Bank, Afribank and Cadbury (Uwalomwa, Daramola & Anjolaoluwa 2014).
Globally, a sense of concern with and inquisitiveness about corporate governance in East Asian countries emerged following the East Asian financial crisis in 1997/1998. The crisis exposed the consequences of frail governance and poor governance standards were responsible circuitously in part for the crisis that debilitated the confidence of foreign investors in the East Asian capital market, including Malaysia (Leng, 2004; Abdul Rahman &Mohammed Ali, 2006). The heartbreaking fiascoes and losses of big firms like Enron Corporation, WorldCom and Tyco International that operated in the well-ordered and efficient capital market of the United States of America, further highlighted the crucial need to improve the corporate governance mechanism in both industrialized and emerging countries. These together with other scandals such as Parmalat in Italy, followed by revelations of misrepresentation of financial statements, have drawn global attention to the need for corporate governance restructuring and improvement in the quality of reported earnings as the capital market needs precise and impartial financial reporting to encourage investors' confidence (Roodposhti & Nabavi Chashmi,2011).

In Nigeria, the collapse of big corporation such as Bank PHB, Spring Bank Plc, Oceanic Bank Plc, Intercontinental Bank Plc, Levers brother, African Petroleum Plc and Cadbury plc signpost the effect of poor corporate governance. An inquiry into the cause showcases significant, deep-rooted glitches in financial reporting and also the premeditated delinquency of the bank managers (Ndukwe & Onwuchekwa, 2014; Egbunike, Ezelibe & Aroh, 2015).

Corporate governance according to Cadbury Report 1992 "is the system by which companies are directed and controlled". It is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled; and also includes the relationships among the many stakeholders (internal and external) involved and the goals for which the corporation is governed.

According to Lin (2006), earnings management involves other procedures which are unequivocally showcased (window dressing) as well as those which are sophisticated (off-balance sheet financing). Merchant and Rockness (1994) define earnings management as any action of management which can distort profits and which is not a consequence of the economic reality, it actually represents the privilege of financial engineering. Thus, the economic entity is presenting to the investors or to the prospective investors' financial statement passed through the filter of some techniques capable of generating a more favorable image on the market but also the illusion of some more attractive results. In the same vein, Earnings management is seen as a universal occurrence, inherent in firms and businesses. Accounting frauds in companies emanate from a culture of extensive earnings management (Mamta &Amarjeet 2016).

Available studies indicate that corporate governance practices significantly influence earnings management practices among listed companies in the Nigerian capital market (Egbunike, Ezelibe & Aroh, 2015; Uwalomwa, Daramola & Anjolaoluwa, 2014; Kamran & Attaullah Shah, 2014). However, following the recent economic recession in Nigeria, no study has been conducted to the best of our knowledge to cover the economic period of ten years beginning from 2005 to 2015 using the two major components of corporate governance - board characteristics and audit committee characteristics respectively. The present study seeks to fill this gap.

## LITERATURE REVIEW

### Theoretical Framework

#### Agency theory

Agency theory is founded on the glitches associated with the separation of ownership and manageability. Agency relationship refers to relationship wherein one party (Principal) delegates the making of decision to another party (Agent) (Craig, 2010). According to Jensen and Meckling (1976) agency problem is the problem that emanates when a Principal enters a contract with an Agent who is to make decisions on behalf of the principal. Such delegation comes with various risk and moral hazards to the executives (Jensen, 1993). An agency problem comes into play when agents set goals that contradict those of the principals and take actions in their own interest (Fama & Jensen, 1983; Boyd, 1995). This study is hinged on agency theory because the researcher is of the view that corporate governance structure ought to work toward maximizing the wealth of shareholders and stakeholders as the case may be.

### Conceptual Framework

#### Corporate governance

Corporate governance is the system by which corporations are directed and controlled and it is aimed at ensuring that managers act for the benefit of the corporation and its stakeholders (Rankin et al, 2012). It involves all the set of processes, customs, policies, laws, and institutions affecting the way a corporation is governed.

**Earnings management**

There are several conceptual views about earnings management in accounting literature. Schipper (1989) defined earnings management as "a purposeful intervention in the external financial reporting process with the intents of obtaining some private gain". Mckee (2005) argued that earnings management is "a reasonable and legal management decision making reporting intended to achieve stable and predictable financial results".

**Board Independence**

The board of directors is said to be independent if outsiders do not exert undue influence on it. Hermanson (2003) alluded that the main basic concept in corporate governance is that the board of directors ought to be independent of management and firm. Fama and Jenson (1983) opined that it is through the inclusion of unbiased parties that a true independence of the board could be attained.

**Board Size**

Board size is the aggregate number of executive and non-executive that form the board of directors. Board size impacts greatly on earnings management and it has become a challenging task to identify suitable board size that influences its ability to perform creditably. Liton and Lorsch (1992) opined that a larger board size is faced with the quandary of social idleness and free riding. Whereas, Singh and Harianto (1989) discovered that larger board size increases the performance of the board by curtailing the predominance of CEO within the board.

**Audit Committee Meeting**

Audit committee meeting means and includes the frequency at which the audit committee meets in a year. Temple (2016) argued that the frequency of committee meetings portrays how efficiently financial statement frauds can be detected. The frequency of their meetings is paramount as it makes them carry out their oversight role and also effectively monitor the performance of managers. Menon and Williams (1994) also opined that the frequency of committee meetings to a large extent establishes its success.

**Empirical Review**

Kankanamage (2015) reported in a work titled "the relationship between board characteristics and earnings management: Evidence from Sri Lankan Listed Companies" that there was a significant relationship between board size, board composition, board financial expertise, and board meetings and earnings management of the firms.

Egbunike, Ezelibe, and Aroh (2015) explored corporate governance influence earnings management practices quoted companies in Nigeria. They adopted the Jones model in their investigation. Primary and secondary data stretching from 2011 to 2014 were obtained for the sampled companies and analyzed using tables, simple regression techniques. Their findings revealed that board size, board independence, firm size, and strength of the audit committee have a significant influence on earnings management practices of the quoted companies. Therefore, improvement in corporate governance codes for corporations was recommended.

Similarly, Uwalomwa, Daramola, and Anjolaoluwa (2014) examined the effects of corporate governance on earnings management in 40 listed companies in the Nigerian stock exchange market for the period 2007 to 2011. Data were analyzed using the regression statistical technique. Their findings showed that board size and board independence have a significant negative impact on earnings management in the sampled firms. They resolved that corporations with larger boards are more likely constrain earnings management than smaller boards because they tend to have more independent directors with financial or corporate expertise.

Awaisu and Rabi'u (2015) in "the effect of board the size and audit committee the size on earnings management in Nigerian consumer industries companies" reported that audit committee size negatively and significantly affects earnings management, and that larger board is not efficient to curtail the tendency of managing earnings.

Hassan (2014) examined the influence of characteristics of directors and characteristics of audit committee on audit fees 112 non-financial companies listed on Jordan's Amman Stock Exchange (ASE). His first result revealed a significant and positive relationship between external audit fees and board of directors' independence, expertise, and size. His second finding revealed that audit committee expertise and the number of audit meeting did not show any significant relationship with audit fees. His other result revealed that audit committee independence is significantly positively associated with the level of audit fees.

Temple (2016) investigated the effect of audit committee number of meetings on the quality of financial reporting in banks listed on the Nigerian Stock Exchange as at 31st December 2014. The correlation research design and the modified Jones model were used for the investigation. The Pearson product moment correlation coefficient and simple regression analysis were utilized to analyze the data. It was discovered that the interface between audit committee number of meetings and quality of financial reporting was revealed to be statistically insignificant. He recommended that the audit committee members should regularly meet and that the financial statement of the quoted banks should be thoroughly checked as this will go a long way to reduce financial statement fraud.

The above empirical studies present that corporate governance components measured by board independence, board size, and audit committee meeting have an influence on earnings management. Hence, this study empirically tries to answer the under listed questions:

1. To what extent does board independence impact on earnings management?
2. To what extent does board size influence earnings management?
3. To what extent does audit committee meeting influence earnings management?

Based on the above-stated questions, the study provides three hypotheses in the null form:

**$Ho_1$**: Board independence does not have a significant impact on earnings management.

**$Ho_2$**: Board size does not have a significant influence on earnings management.

**$Ho_3$**: Audit committee meeting does not have a significant effect on earnings management.

## RESEARCH METHODS

The study is a longitudinal survey of ten years beginning from 2005 to 2015. All the twenty-seven (27) consumer goods companies quoted on the floor of the Nigerian Stock exchange as at 31st December 2015 constitute the population for the study as they all had the required data for the study.

### Model Specification

The model to take into custody the pertinent relationship is expressed in three forms. First, functional expression of the model is as shown below:

$Y = f(x_1, x_2, x_3)$

EM =f (BI, BS, ACM)………………………. (1)

Second, mathematically;

$EM_t = \alpha_0 + \beta_1 BI + \beta_2 BS + \beta_3 ACM$…………………. (2)

Third, econometrically;

$EM_t = \alpha_0 + \beta_1 BI + \beta_2 BS + \beta_3 ACM + \mu_t$……………………… (3)

Where:

EM = Earnings management measured by discretionary accrual

$\alpha_0$= Constant

$\beta_1$ - $\beta_3$ = Coefficient or intercept

BI = Board Independence

BS = Board Size

ACM = Audit Committee meeting

$\mu_t$ = Stochastic error term

## RESULTS AND DISCUSSION

**Hypothesis 1:**

Board independence does not have significant impact on earnings management

Table 4.1

**Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -4.484 | .740 | | -6.059 | .000 |
| | Board independence | .193 | .107 | .110 | 1.808 | .072 |

a. Dependent Variable: Earnings management

Table 4.1 reveals that Board independence (beta = .110, t = 1.808, sig., .072) positively and significantly impact on Earnings management of consumers companies in Nigeria. Therefore, the null hypothesis is rejected. This finding is in congruence with the findings of Hassan (2014) which revealed a significant and positive relationship between external audit fees and board independence, expertise, and size. However, our finding is inconsistent with the findings of Uwalomea, Daramola, and Anjolaoluwa (2014) that board independence have a significant negative impact on earnings management.

**Hypothesis 2**:

Board size does not have significant influence on earnings management

**Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -3.785 | .776 | | -4.878 | .000 |
| | Board Size | .062 | .078 | .048 | .792 | .429 |

a. Dependent Variable: Earnings management

From Table 4.2 above Board size (beta = .048, t = .792, sig., .429) positively but not significantly influence on Earnings management of consumer goods companies in Nigeria. Therefore, the null hypothesis is accepted. Our result is not in concordance with the findings of Kankanamage (2015) and Egbunike, Ezelibe, and Aroh (2015) that revealed a significant relationship between board size and earnings management of the firms.

**Hypothesis 3:**

Audit committee meeting does not have significant effect on earnings management

**Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -2.787 | .650 | | -4.287 | .000 |
| | Audit committee meeting | -.134 | .199 | -.041 | -.675 | .500 |

a. Dependent Variable: Earnings management

Table 4.2 above indicates that Audit committee meeting (beta = .041, t = .675, sig., .500) positively but not significantly affect Earnings management of consumers companies in Nigeria. Therefore, the null hypothesis is accepted. Our finding agrees with the findings of Temple (2016) that reported a statistically insignificant relationship between audit committee number of meetings and quality of financial reporting. Again our finding is in congruence with the findings of Hassan (2014) that the number of audit meeting did not show any significant relationship with audit fees.

## CONCLUSION AND RECOMMENDATIONS

This study revealed that board independence and board size do have significant impact on earnings management but audit committee meeting does not have a significant effect on earnings management. Therefore the study recommends small board size and also advocates that the audit committee should meet more often as this will go a long way in curtailing earnings management. Lastly, the corporate governance codes should be strengthened in such a way that the independence of the board will not be hampered.

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