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Earnings Management and Board Structure: Evidence From Nigeria

Imoleayo F. Obigbemi[1], Eddy O. Omolehinwa[2], Dick Oluku Mukoro[1], Egbide Ben-Caleb[1], and Olamide Adeola Olusanmi[1]

Abstract

The board structure of an organization gives an overview of the standard of such organization, which also influences its public image. This study attempts to evaluate the role board structure plays in curtailing earnings management practices in Nigerian companies. This study sampled the data of 137 quoted companies in Nigeria for a period of 8 years (2003-2010). Earnings management was measured using the magnitude of the discretionary accruals as estimated by the performance matched modified Jones model. The ordinary least squares (OLS) regression technique was used to measure the research model as well as the Pearson moment correlation coefficient. The study shows that there is a significant relationship between board structure and earnings management practices in Nigeria. The study shows that there is a negative significant relationship between board size, gender, and board composition with earnings management; also, there is a positive significant relationship between board meeting and earnings management practices in Nigeria. There is a positive nonsignificant relationship between the presence of a remuneration committee and the dualization of CEO and chairman positions with earnings management practices in Nigeria. This study recommends that regulators at all levels should enforce the preparation and publication of financial reports by companies operating in Nigeria.

Keywords

earnings management, board composition, board size, gender equality, board meetings

Introduction

Accounting exists primarily to provide relevant information to the various stakeholders; the information provided, however, is dependent on the type of relationship that exists between the company and the stakeholder (Obigbemi, Iyoha, & Ojeka, 2015). Accounting, which is also referred to as the language of business, informs the various stakeholders of a business the summary of all activities that transpired within the business entity during the reporting period in a quantitative manner (Amernic & Craig, 2009; Tsai & Chiou, 2009). Accounting is also the channel of communication in a business enterprise through which the managers of the business relate with the owners and other stakeholders in the business serving as a medium through which stewardship and accountability are reported (Amernic & Craig, 2009). Accounting information, however, is expected to fulfill the purpose of minimizing uncertainty about the state of affairs in the reporting entity (Akintoye, 2008).

The stakeholders of a business enterprise who are the users of its financial reports (Appalachian, 2006; Freeman, Wicks, & Parmar, 2004; Murya, 2010; Universal College of Accountancy, 2004) make use of the reports for several purposes. The contents of these reports, however, are financial data, which, if properly analyzed, are transformed into accounting information that is used for economic decision making by the users (Murya, 2010; Tsai & Chiou, 2009). The users of accounting information can be divided into internal and external users (Koornhof, 1998). The internal users are those who make decisions directly affecting the internal operations of an enterprise, whereas the external users are those who use the financial and nonfinancial information of a business enterprise to make decisions concerning their relationship with the enterprise on whether to continue, withdraw, or improve on their present level of business relationship (Koornhof, 1998; Universal College of Accountancy, 2004). Both groups benefit by receiving the needed information to make economic decision (Sori, 2009; Tsai & Chiou, 2009).

[1]Covenant University, Ota, Ogun State, Nigeria
[2]University of Lagos, Akoka, Yaba, Nigeria

Corresponding Author:
Imoleayo F. Obigbemi, Department of Accounting, Covenant University, Canaanland, Ota, Ogun State, Nigeria.
Email: imole.obigbemi@covenantuniversity.edu.ng

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However, the ability of the financial report to meet the needs of its users is what informs its usefulness and the level of reliability placed on it by its users; thus, when a financial report is unable to meet the needs of its users, it becomes of low value (Accounting Aisle, 2011; Hand, 2003; Kothari, Ramanna, & Skinner, 2010; Stanford Graduate School of Business, 2005; Uadiale, 2012). The value of financial data is subject to the quality of report presented, which is subject to the rate at which the users rely on the information it gives (Kothari et al., 2010). If the content of the financial data is faulty, it gives a wrong picture of the business enterprise, which also affects the level of reliance placed on it by the users and finally faulting the credibility of the financial report (Uadiale, 2012). The reliability of accounting information may affect its relevance to the market in determining the firm value (Otusanya & Lauwo, 2010).

To enhance the value of financial statements, the information needs of the various users must be met (Revsine, 1969). However, due to the numerous users and their divergent interest in the company, the manager is faced with the challenge of reporting to meet the information needs of all. The external users of accounting information are creditors, investors, financial analysts, government, general public, and so on, while on the list of the primary users of the financial reports are the shareholders, employees, and the managers, who have divergent interests (Ireland, 2005). The users of the financial reports all deduce various information from the reports that should satisfy the needs of all the users; thus, the managers are faced with the challenge of how the reports should be prepared, which is because of the divergent interests of the various users. In an attempt to meet the divergent needs of the users of financial report, the Generally Accepted Accounting Principles (GAAP), alongside other regulatory documents such as the Companies and Allied Matters Act (1990) as amended, The National Accounting Standards (now Financial Reporting Act (2011) Bank, and other Financial Institution Act (for financial institutions), and so on, that serve as guidelines for the preparation of financial reports were adopted in Nigeria.

In the preparation of the financial reports, the managers of companies, who serve as the agents of the other stakeholders, may prepare the reports in a way that best suit them, and their decision-making process, which may not necessarily be to the advantage of the other stakeholders. For example, a manager in a bid to boost production of the next season may decide to increase the company's retained earnings at the detriment of the ordinary stock shareholder who is interested in receiving high dividend at the end of the period, while the manager may also decide to go for bank loan, which may also affect the collateral base of the debenture holder. The managers, because of their privileged position, may exert immense control over the running of the company, the allocation of resources on behalf of shareholders as well as controlling the information to be disclosed to capital providers. Self-interested motive, such as the reduction in the cost of research and development to increase book profit as well as the use of other creative accounting measures, to boost bonus, and commission, induces managers to divert firms' resources to activities that are detrimental to the objective of maximizing shareholders' wealth (Ramly & Rashid, 2010). This act is as a result of the use of the GAAP that requires the use of judgment, or discretion on the part of the manager (accountant), in the preparation of the financial reports (Bello, 2011; Joseph & Atul, 2007). At times, the exercise of accounting discretion allows managers to manage earnings by shifting revenue or expense items from one accounting period to another accounting period. When this happens, it reduces the total expenses for the reporting year, thereby increasing profit; also, when revenue is anticipated in a future date, it may be recorded in the current year thereby increasing profit. When there is also a sign of loss in a future date, current year revenue may be delayed and recorded in a future date. These acts and many more can therefore be referred to as earnings management. In the case of the Enron Saga, which is a typical example of corporate failure, it was identified that the fall was as a result of the failure of the board of directors and management to take responsibility for the risks inherent in the company's business plan, and the use of the special purpose entities and related forms of structured finance, thus a misuse of off balance sheet financing as well as conflict of interest which led to the enrichment of some officers of the company (Deakin & Konzelmann, 2004).

Earnings management, therefore, can be referred to as an act of maximizing the loopholes in the financial reporting laws, to maximize personal, group, or organizational objectives at the detriment of another group of individuals who may be directly or indirectly affected by such decisions. Earnings management can take the form of creative accounting such as recording anticipated sales in the books as turnover for the present year, as well as the reduction in the cost of research and development. Earnings management could also involve the use of discretionary accruals, the accumulation of accrued expenses in the bid to give a different picture of the financial well-being of the company. It is the use of deceitful actions by the preparers of the financial reports, which may be at the detriment of the other stakeholders, which is the deviation of management from shareholders' interest (Murya, 2010). One example of management's deviation from shareholders' interests is the management of earnings with the use of accounting accruals (Beaudoin, 2008; Bugshan, 2005; Murya, 2010). For example, such techniques may include altering (i.e., either delaying or accelerating) actual cash flow expenditures such as advertising and research and development. (When advertising and research and development expenditures are delayed, this will, however, reduce the total expenditure for the year, thus increasing profit on the short run, but will affect the business profit on the long run.) This type of earnings management is called the opportunistic earnings management, whereby the manager seeks to mislead investors by pursuing his personal

interest of increasing incentives such as bonus and commission, which may be a function of reported profit at the detriment of the other stakeholders, who are interested in the survival and long-term profitability of the company (Liming, Charlotte, & Shannon, 2005).

In the year 2003, the Nigerian Code of Corporate Governance was published, with the expectation that adherence to the contents of the code by Nigerian companies will increase the level of confidence in the economy (Adegbite, 2012a, 2012b), as a result of the increase in confidence placed on the financial reports of companies operating in the country, which thereafter translates into increase in the rate of investment in the economy (Samaha, Dahawy, Hussainey, & Stapleton, 2012). Therefore, there is a need to identify the various factors that may affect earnings management practices in Nigeria with respect to the role corporate governance plays in its reduction.

Review of Literature

Earnings management is a topical issue that has been widely reviewed and evaluated from different perspectives and dimensions in accounting literature as well as documentaries. It has received great attention globally, and its effect on the level of reliability is placed on the financial reports of companies (Beaudoin, 2008; Bugshan, 2005; Murya, 2010; Uadiale, 2012). However, there seems to be dearth of information on earnings management practices in Nigeria and the Nigerian firms (Bello, 2011; Okoye & Alao, 2008), though different questions have been raised on the reasons for corporate failures in the Nigerian environment (Anaro, 2011) even when reported earnings look vibrant and portray that of a going concern (Ogunwusi & Eazee, 2011).

Many preparers of financial reports have been accused of engaging in various forms of earnings management practices, in a bid to either secure their job by giving the users of the reports what they want to see and not necessarily report the situation in the company (Bello, 2011; Tsai & Chiou, 2009), which is as a result of the divergent interest of the various users of the accounting information and the resultant effect of which is the reduction in the value placed on financial reports by the users of the report (Okoye & Alao, 2008). In an attempt to reduce this trend, the code of corporate governance was published in 2003 in Nigeria, by the Securities and Exchange Commission (SEC) in conjunction with the Corporate Affairs Commission (CAC), the document that is believed to bridge the gap between the information need of the various users of the financial reports. The code looked at the ways by which companies could be managed in such a way that the interest of the various stakeholders in the company is considered in the management of the company, the preparation of the reports, and the presentation of the reports for the various users (SEC, 2003).

In developed countries, research has shown that corporate governance reduces the earnings management practices carried out in companies, giving greater credence to the financial reports of companies; however, the opposite happens to be the case in Nigeria, where the code was published in 2003 and quoted companies have been mandated to adhere to the contents of the code. A close look at the Nigerian business environment shows that from 2003 to date, there have been several cases of company fold up and financial scandals in Nigeria (Anaro, 2011; Ighomwenghian, 2010; Microfinance Africa, 2010; Ogunwusi & Eazee, 2011; Onwuamaeze, 2008). This, however, poses a question on the efficacy of the code of corporate governance in Nigeria and its effect on earnings management practice. Is corporate governance a variable responsible for the discovery of the various scandals; has it improved financial reporting integrity; and what is the extent of compliance to the code of corporate governance in Nigeria?

Accruals Management

Accruals refer to the difference between income from continuing operations and cash flow from operations resulting from accounting rules and journal entries for the recognition of revenues and expenses (Dharan, 2003). According to Dechow (1994), accounting accruals is a product of accounting entries and management estimations having no cash flow effect. Accrual management is done easily through accounting decision and does not require the creation of a new business transaction. It is usually done by one manager or a group of managers. According to Dharan (2003), there is a common practice in many organizations known as Garden-variety earnings management where a manager may increase or decrease the levels of accounting accruals (such as accounts receivable, inventory, accounts payable, deferred revenue, accrued liability, and prepaid expenses) to reach a desired profit.

Accrual management is not a common area for accounting researchers but still remains a very significant part of financial engineering, which depletes the worth of an organization. There is a need to secure control over accrual management and the manipulations of accruals, but the methods of these manipulations are still being researched into. According to (Iyoha, 2011), the higher the index of accruals of companies, the poorer is the quality of accounting information supplied by the reporting company; thus, the closer the accrual index to zero, the better is the quality of financial reporting. However, in a country like Nigeria, where the accrual concept is used in financial reporting and so many companies operate on credit basis, how easy is it then for Nigerian companies to have an accrual index of zero?

Discretionary Accruals

Discretionary accruals are adjustments to cash flows selected by the manager to affect reported income (Healy, 1985). They are those accruals that are reported by the managers of

a business enterprise voluntarily and not as stipulated by law or as regulated by standards. Discretionary accruals have been seen in literature as a major source of earnings management (Beaudoin, 2008; Bugshan, 2005; Hutchinson & Leung, 2007; Murya, 2010). The impact of discretionary accruals on the information content of earnings is subject to debate as the disclosure manipulations could enhance the value relevance of reported earnings of a company (Bugshan, 2005). The most popular discretionary accruals models are the Healy model, DeAngelo model, the Jones model, the modified Jones model, the industry model, and the Cross-Sectional Jones model as well as the performance matched discretionary accruals. The Healy model is the maiden work for the separation of accruals into discretionary and nondiscretionary accruals giving the conclusion that the discretionary part of accruals indicates earnings management trend by companies, identifying some of the shortcomings of the Healy model. DeAngelo model, in an attempt to correct the shortcoming, propounded another model for the separation of accruals into discretionary and nondiscretionary.

Jones, while reviewing the DeAngelo model, propounded a model, which received wide acceptance, whereby regressing total accruals and separating it into discretionary and nondiscretionary accruals. The Jones model was not without limitation, as it was identified that the model did not consider the use of accounts receivables by managers in managing earnings; this, therefore, led to the adoption of the modified Jones model. The modified Jones model was, however, complemented with the performance of companies in an attempt to consider the investment pattern as well as the effect of performance on accruals and earnings management, which resulted in the adoption of the performance matched modified Jones model (Kothari, Leone, & Wasley, 2005).

Discretionary accrual is that part of total accruals that is more susceptible to manipulation by managers (Huang & Liu, 2011). Discretionary accruals are easier to manipulate but difficult to be detected (Tsai & Chiou, 2009). Managers have some scope to manage reported profits by the use of discretionary accruals. Although these accruals "reverse" in future years, managers may have incentives to move profits from one year to the next (Chung, Firth, & Kim, 2002). The use of discretionary accruals as an earnings management tool arises as a result of managers' freedom to exercise judgment in the preparation of their financial report. However, it is difficult for researchers to distinguish the discretionary portion of total accruals used for manipulation by the managers.

To resolve this phenomenon, prior studies have proposed a variety of models for the separation of accruals into discretionary and nondiscretionary accruals estimation models to estimate the discretionary components of accruals (Kothari et al., 2005; Murya, 2010; Tsai & Chiou, 2009). In literature, it has been said that managers can use their discretion on certain accruals to manipulate accounting earnings, which is as a result of the loopholes in the accounting principles and guidelines for the preparation of financial reports. Thus, discretionary accruals are commonly used by researchers as the proxy for earnings management.

Nondiscretionary Accruals

Nondiscretionary accrual is a mandatory expense/asset that is recorded within the accounting system that is yet to be realized. An example of this would be payroll taxes. Nondiscretionary accruals are the obligatory transactions in the books of account that cash is yet to be realized. These are the compulsory disclosures according to the relevant accounting standards of the home country of the reporting company. The nondiscretionary component of a financial report reflects the company's business conditions (such as growth and the length of the operating cycle) that naturally create and destroy accruals (Murya, 2010). There are many approaches used in an attempt to estimate the nondiscretionary accrual proxy, but estimating the nondiscretionary component of accruals typically involves a discretionary model (Bugshan, 2005).

Earnings Management

Earnings management is a deliberate attempt to arrive at a desired level of earnings using different means, which is considered an unethical practice (Bello, 2011). Earnings management can take many forms and include numerous deceitful actions as a result of managers' use of judgment in financial reporting. Earnings management extends to cover manipulations other than accounting choices; thus, the implications of accounting choice to achieve a goal are consistent with the idea of earnings management (Bugshan, 2005; Murya, 2010). Earnings management, however, involves the preparation of financial reports in accordance to what correlates with the effort of the managers, such as enhances the worth of the company and that of the accountants. The flexibility of the accounting regulations makes it easy for managers to manage earnings (Okoye & Alao, 2008). According to Gunny (2005), earnings management can be classified into three categories: fraudulent accounting, accruals management, and real earnings management. Fraudulent accounting involves accounting choices that violate GAAP; accruals management involves the use of discretion in the presentation of accruals elements in the financial reports; whereas real earnings management involves the use of discretion in changing the regular operational activities of the organization to achieve certain objectives.

The nature of accrual accounting gives managers a great deal of discretion in determining the actual earnings a firm reports in any given period. The most common practice is to manipulate the timing of expenditures such as advertising expenses or outlays for research and development. There are two types of accrual-based earnings management—opportunistic and informative earnings management. Opportunistic earnings management means that managers seek to mislead

investors by pursuing the management's interests (Tsai & Chiou, 2009). This type of earnings management is engaged in by managers to achieve personal objectives at the detriment of the organizational objectives and that of other stakeholders. The informative type of earnings management aims at enhancing the value of the firm, through the managers, by revealing to investors their expectations about the firm's future cash flows (Murya, 2010).

Literature on opportunistic earnings management originated from Healy (1985), when it was found that managers use accruals to strategically manipulate bonus income (Murya, 2010). If managers believe that the board views any increase in earnings positively, they may act opportunistically by opting for income-increasing accounting policies. Earnings management, however, may also be informative in nature, whereby aiming at maximizing the value of the firm, which involves the use of discretion by the managers in the revelation of the private expectations of investors about the firm's future cash flows, which could boost the company's public image, thereby allowing the forces of demand and supply play a major role in increasing the value of the company's shares. Under this form of earnings management, stockholders gain because it is used to signal the manager's private information (Murya, 2010).

In a study conducted by Robert and Seybert (2009), it was concluded that stock price as well as general reputation concerns are the primary motives for managers' earnings management attempts. They further stated that other motives such as debt covenants, bonus compensation, and taxes play secondary roles in earnings management practices. Managers also prefer earning management methods that are not easily detected such as alterations of estimates and allocations in areas where accounting standards are imprecise such as change in investment choices (Robert & Seybert, 2009).

Ethical Issues in Earnings Management

Ethical earnings management practices include the use of derivative securities to edge business against risk, whereas unethical earning management practices include accrual management, that is, artificial shifting of expenses between periods. Earnings management can also be practiced through the modification of the useful lives of depreciable assets, change of estimated receivables. Firms tend to use earnings management to improve their financial numbers and subsequently reinforce compensation. Earnings management has been seen to be prevalent in countries with weak legal enforcement systems (Okoye & Alao, 2008). The flexibility inherent in the GAAP used in the preparation of financial statements has made it easy for preparers of financial reports to engage in unethical practices, which is as a result of the freedom enjoyed by the financial managers to select from accounting alternatives and methods (Bello, 2011; Joseph & Atul, 2007). Thus, this flexibility is what leads to the use of discretion by managers in the allocation of accruals in financial reporting, which therefore increases discretionary accruals as well as earnings management practices by managers.

Earnings Management and Accounting Regulations

Close enforcement of the accounting regulations and the enactment of workable laws have been said to be major tools for the reduction of earnings management practices in Nigeria (Okoye & Alao, 2008); liberal accounting law has been said to create lots of opportunities for managers to actively engage in earnings management (Van, 2002).

In a study conducted in China by Chen, Lee, and Li (2008), it was observed that with rigid rule-based accounting, the listed firms have limited instruments for earnings management, whereas Shaomin, David, and Michael (2011) noted that in mature economies like the United States with considerable market pressure on managers to show positive earnings, the practice occurs frequently and tends toward an upward adjustment of reported earnings over actual profits. Xiao, Chi-Wen, and Jing (2008) discovered that there is collusion between local government and listed firms in earnings management; it was discovered that this exists mainly in firms controlled by local governments, all in a bid to avoid the central government regulations.

According to Masako, Hamid, and Shahrokh (1998), although Japanese managers manipulate reported earnings to appear more profitable, the cost of the manipulation is much higher for Japanese managers due to a high level of conformity between financial reporting and tax reporting. This is as a result of the high tax regulation that exists in the country, compared with their U.S.-based and Nigeria-based counterparts, which, in a bid to increase reported profit, may result in an increase in tax liability of the companies. The stringent tax laws in a country like Japan, however, make its earnings management approach different from that adopted by Nigerian companies, as any attempt by the Japanese companies to increase profit before tax may result in high tax liability, which although exists in Nigeria, but due to the lapses in the Nigerian tax law, Nigerian companies engage in tax-avoidance practices maximizing the benefits in the loopholes of the tax laws. Multinational firms with extensive operations in tax havens manage earnings more than other firms (Dyreng, Hanlon, & Maydew, 2012) that are not multinationals or do not have subsidiaries in countries with less stringent laws.

Real Earnings Management

This is the earnings management that involves the use of discretion by the managers to achieve a specific objective with respect to change in normal business activity (Masahiro, Fumihiko, & Tomoyasu, 2013). In a study conducted by Gunny (2005), it was suggested that real earnings management activities are associated with an economically significant decline in subsequent operating performance. This,

therefore, means that real earnings management is informed by the performance of the companies that engaged in it.

In a study conducted on 38 countries, it was discovered that real earnings management is preferred over accrual-based earnings management in countries with stronger investor protection (Masahiro et al., 2013). However, because of the nature of the Nigerian country with respect to investor protection and the loose regulatory system, this study will be adopting the accrual-based earnings management.

Corporate Governance

Companies have gained deeper understanding of how good corporate governance contributes to their competitiveness. Investors, especially collective investment institutions and pension funds acting in a fiduciary capacity, have realized that they have a role to play in ensuring good corporate governance practices, thereby underpinning the value of their investments. Economies all over the world are now interested in corporate governance, with the understanding that it goes beyond the interest of shareholders and the performance of individual companies, but the entire economy. Therefore, corporate governance is important to broad and growing segments of the entire population. As companies play a pivotal role in the economic development of countries and reliance on companies has increased, there is a need for good corporate governance (Organisation for Economic Co-Operation and Development [OECD], 2004).

Corporate governance is affected by the relationships among participants in the governance system. Controlling shareholders, which may be individuals, family holdings, bloc alliances, or other corporations acting through a holding company or cross shareholdings, can significantly influence corporate behavior. As owners of equity, institutional investors are increasingly demanding a voice in corporate governance in some markets. Individual shareholders usually do not seek to exercise governance rights but may be highly concerned about obtaining fair treatment from controlling shareholders and management. Creditors play an important role in a number of governance systems and can serve as external monitors over corporate performance. Employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance (OECD, 2004).

As a result of the reported scandals, the highly publicized corporate failures worldwide, and the increasing concern of the global community on the issues of corporate governance, there has been a growing consensus that corporate governance, which has been defined as the way and manner in which the affairs of companies are conducted by those charged with the responsibility of managing the company (SEC, 2003), has a positive link to national growth and development. Several Codes of Corporate Practices and Conduct have been fashioned out and are in use in various jurisdictions.

The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower, and firms are encouraged to use resources more efficiently, thereby making corporate governance one key element in improving economic efficiency and growth as well as enhancing investor confidence. Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring underpinning growth (OECD, 2004).

As a result of the identified benefits of good corporate governance, developed and developing countries have published several codes to resolve the corporate governance issues as a result of the identified challenges in companies. However, there is no single model of good corporate governance, but some common elements have been identified (OECD, 2004). Realizing the need to align with the International Best Practices, the SEC in collaboration with the Corporate Affairs Commission inaugurated a 17-member Committee on June 15, 2000, in Nigeria, which looks into the enactment of a code of corporate governance in line with the international expectation. The Committee, as headed by Atedo Peterside, was mandated to identify the weaknesses in the current corporate governance practice in Nigeria as at that date and fashion out the necessary changes that would improve the Nigerian corporate governance practices.

Membership of the Committee was selected to cut across all sectors of the economy including members of professional organizations, organized private sector, and regulatory agencies. The Committee submitted a draft Code, which was published in several newspapers and was further reviewed at three locations across the Country, namely, Lagos, Abuja, and Port Harcourt. An extensive exposure that was designed to elicit stakeholders' input was sent out to various stakeholders like managers, bankers, investors, regulators, and so on, before the Code was finalized and approved by the Boards of the SEC in 2003, being the regulatory authority of the Capital Market, and the Corporate Affairs Commission being the regulatory authority of Companies in Nigeria as the Code of Best Practices for Corporate Governance.

The Nigerian SEC, as well as the Corporate Affairs Commission, is expected to enforce due compliance or otherwise of the provisions of the Code in the treatment of issues brought before them. However, all other regulators and self-regulatory organizations are expected to ensure that their

rules and regulations incorporate relevant aspects of the Code. The Central Bank of Nigeria mandated all banks in Nigeria to fully adhere to the content of the code, with different control measures set up to enforce full compliance.

Literature has shown that several variables can be used in the measurement of the strength of corporate governance in a company. The impact of the various variables and their effect of the organizations have been explored in literature and conclusions reached thereby. This study, however, will be considering some of these variables as reviewed in literature and their informed effect on the governance structure of any company.

Board Composition in Companies

Research on board composition and board leadership structure has also been dominated by a focus on company performance (Dally & Dalton, 1999), which is consistent with the institutional investment community's demands for more independent board structures. The general notion is that boards with higher proportion of nonexecutive/independence directors are generally objective and independent in their monitoring function (Bello, 2011). The Nigerian Code of Corporate Governance stipulates some requirements for the composition of board members in companies. The Code stipulates that the board should be composed in such a way as to ensure diversity of experience without compromising compatibility, integrity, availability, and independence. It states that the board should comprise of a mix of executive and nonexecutive directors, to be headed by a chairman of the board, and the composition of the board should not exceed 15 persons or be less than five persons in total. Members of the board should be individuals with upright personal characteristics and relevant core competences, preferably with a record of tangible achievement, knowledge on board matters, a sense of accountability, integrity, and commitment to the task of corporate governance and institution building, while also having an entrepreneurial bias.

According to Duztas (2008), boards are important boundary spanners, as they can be used as a mechanism to form links with the external environment and achieve interorganizational linkages, such as the appointment of outside directors and board interlocks, which can be used to manage environmental contingencies. Directors who are prestigious in their professions and communities can give timely information to executives and also use that information as a channel for marketing the brand of the company. Also, with the inclusion of external nonexecutive directors, individuals with good managerial skills can be brought on board, which may enhance the oversight functions of the board as a whole. The Code of Corporate Governance is an attempt to ensure that the executive directors do not use their power to run the affairs of the company in a way that is not to the advantage of other stakeholders in the company. A board of directors with more executive directors than the nonexecutive directors is seen as an overbearing board with the assumption that the executive directors will lord major decisions on the entire board, which may boost insider dealings and unethical practices in the company. However, the code states that an equal mix of executive and independent nonexecutive directors is expected to have an independent board.

Duality occurs when the same person occupies both the CEO and chairman positions on the board. Past studies test the chairman's independence and the concentration of power on the board. It is argued in the governance literature that the objectivity and quality of board oversight may suffer if the CEO also chairs the board. Duality of position is envisaged to cause centralization of power in a company, which can result in the CEO being able to exercise excessive influence over the board by setting board agendas, managing meetings, and controlling the flow of information to its members (Murya, 2010). The Nigerian Code of Corporate Governance stipulates that the board of a company should not be dominated by an individual, while responsibilities at the top of a company should be well defined. It further emphasized that the position of the chairman and CEO should ideally be separated and held by different persons with a note that the combination of the two positions in an individual represents an undue concentration of power. The Code, however, gave a clause to the expectation by stating that "In exceptional circumstances where the position of the Chairman and Chief Executive Officer are combined in one individual, there should be a strong non-executive independent director as Vice Chairman of the Board" (SEC, 2003, p. 5).

Corporate Governance and Earnings Management

Earnings are the income and input generated by an organization, which are retained or distributed by the company. When such are retained, they are, therefore, used in the generation of additional revenue. Earnings management therefore can be referred to as the process of achieving financial and managerial (personal or sectional) goals by planning and controlling the financial reporting and accounting activities of an organization effectively and efficiently. This may, however, have an effect on the survival of the business if not checked and controlled. Healy (1985) found that managers use accruals to strategically manipulate bonus income. This phenomenon may be attributable to manufacturing companies and companies that compensate for work done and give commission based on the level of output.

Past researches have, however, shown that there is a negative level of relationship between corporate governance and earnings management (Alzoubi & Selamat, 2012; Bugshan, 2005; Gulzar, Wuhan, & Wang, 2011; Murya, 2010). This study, therefore, aims at evaluating the effectiveness of the Nigerian Code of Corporate Governance and the level of relationship that exists between corporate governance and earnings management in Nigeria. Corporate governance is

affected by the relationships among participants in the governance system (OECD, 2004).

Earnings Management and Board Composition

The Nigerian Code of Corporate Governance stipulates that every company incorporated in Nigeria and listed on the Nigerian Stock Exchange (NSE) is expected to have board of directors, who are the individuals nominated by the shareholders of the business to coordinate the activities of the managers and other principal officers in the company. The board of directors is expected to control the excesses of the managers and also represent the shareholders in the company. A study conducted by Gulzar et al. (2011) shows that board of director's characteristics are significantly associated with the earnings management and that the presence of female directors in the board helps to reduce the level of earnings management.

Chtourou, Bedard, and Courteau (2001) observed that effective board composition helps in constraining earnings management in companies. The level of board independence and the mix of board members of the board, to comprise of executive and non executive directors has been the focus of literature with respect to earnings management in companies and mostly the corporate governance literature. Epps and Ismail (2009) identified that firms with annually elected boards, small size boards, have more negative discretionary accruals. However, firms with 75% to 90% independent board or firms with a board size of between nine and 12 have higher positive discretionary accruals. This, therefore, is a pointer to that fact the higher the board size, the lower the earnings management and vice versa. Ghosh, Marra, and Moon (2010), however, found that earnings management does not vary with board composition. This study, however, aims to find out the type of relationship that exists between earnings management and board composition.

Earnings Management and Frequency of Board Meetings

The Nigerian Code of Corporate Governance stipulates the required number of times members of the audit committee are expected to meet in a year. It states that the members of the board must meet at least once in a quarter, which means they are expected to meet at least 4 times in a year for the board to be effective in the discharge of its duties. Past research shows that the frequency of board meetings has an effect on earnings management trend in companies (Xie, Davidson, & DaDalt, 2003). Gulzar et al. (2011) found that if the frequency of board meetings is more, then the value of discretionary accruals is lower; they stated that higher frequency of board meetings will improve the board monitoring. Sarkar, Sarkar, and Sen (2006) argued that it is not board independence, but board quality that is important for earnings management; they further identified that diligent boards are associated with lower earnings manipulation, whereas boards that have large number of multiple directors exhibit higher earnings management. This, therefore, connotes that board that meets often and discharges its duty diligently and effectively may help in the reduction of earnings management.

Earnings Management and Duality of Chairman and CEO Positions

The chairman of a company is an individual who is responsible for the effective operation of the Board; he sees to it that the board members are effectively constituted and that they carry out their responsibility as expected, whereas the CEO is an individual who is responsible for the effective operation of the day-to-day activities of the company. These two have power to make major decisions in the company that may affect the company positively or negatively (Obigbemi, Mukoro, & Obamiro, 2016). In light of this, the Code of Corporate Governance therefore states that these positions must not be occupied by an individual as this may lead to the investure of too much power in an individual, which may be harmful to the company and other stakeholders in the company.

In a study conducted by Saleh, Iskandar, and Rahmat (2005) in Malaysia, it was discovered that there is a positive level of relationship between earnings management and duality of chairman and CEO position; thus, it means when the two positions are handled by an individual, there is every likelihood that earnings management practice will take place. A study conducted in China by Sarkar et al. (2006) discovered that CEO duality and presence of controlling shareholders on the board increase earnings management. Gulzar et al. (2011) also found that there is a positive relationship between earnings management and the duality of CEO position and chairman position. This, however, shows that the dualization of the two positions makes it possible for concentration of power, which may aid earnings management practices in organizations.

Generally, few studies examine the role of corporate governance on earnings management practices in Nigeria, and few have used primary data (Uadiale, 2012). Due to gap in literature with respect to board structure and earnings management practices in developing economies, this study examines the role of board structure on earnings management practices in a developing economy like Nigeria, using the financial reports of sampled companies listed on the stock exchange of the country over a period of 2003 to 2010.

Method

This study adopts the empirical and analytical method of research that involves the evaluation of a subject matter over

a period of time to draw inference for decision making and conclusion. The study examines the effect of board structure on the earnings management practices of companies in Nigeria. The population of this study comprises of all listed companies on the NSE. The annual reports of the NSE show that a total of 217 companies were quoted from 27 sectors as at December 2010. For a given company to qualify in the sample, it must have submitted its financial information within the period of the study. The sample size was derived using the Slovin's sampling technique formula:

$$n = \frac{N}{1 + Ne^2},$$

where n = sample size, N = total population/sample frame (217), and e = error tolerance (0.05).

Using the above formula, with a sample frame of 217 companies, the sample size came to 141 companies that meet the data-gathering criteria, albeit, 137 companies were sampled, which represent 97% of the calculated sample size; 137 companies were sampled because of inability to access the financial reports of some of the companies for the study period. The data retrieved from their financial reports were used for data analysis. However, the unavailability of the required data of some years for some companies made the panel data an unbalanced one and was treated as such.

A test for heteroscedasticity of the data shows that the data are heteroscedastic; this may be as a result of the variation in the number of samples per company as well as the variation in the size of the sampled companies. This is because this study did not separate the companies according to their sizes. To resolve the problem of heteroscedasticity, in accordance with the suggestions of Kim and Imai (2012) on the correction of heteroscedastic data, weight was applied, which gave rise to the use of the weighted fixed effect regression method. Thus, the weight was applied based on the individual company characteristics of the sampled companies. This is to ensure that the individual company characteristics are considered appropriately as they relate to earnings management practices and corporate governance variables as measured by the study.

The weighted fixed effect regression was used to estimate the level of relationship that exists between earnings management and corporate governance practices in Nigeria. After the earnings management equation was solved using the performance adjusted modified Jones model, the residual of this model was regressed against the corporate governance data gathered.

Model Specification

This study established the type of relationship that exists between corporate governance variables and earnings management practices in Nigeria. This study anticipated that a negative relationship exists between corporate governance and earnings management, which means that as corporate governance increases, earnings management practices reduce and vice versa.

$$Y = f(X),$$

where Y is the dependent variable and X is the independent variable.

Following this explanation, with Earnings Management (EEM) as the dependent variable and Corporate Governance Indices as the independent variables, this relationship can be represented as follows:

$$\text{EEM} = f(COG), \tag{1}$$

where EEM is Earnings Management, the dependent variable, proxied by the absolute value of the residual from the performance matched modified Jones Model; and COG is Corporate Governance Indices, the independent variables, which comprise some indicators, namely, Board Structure (BodStruc), which is the aggregate of Board Size (BS), Remuneration Committee (REMCOM), Gender Diversity (GENDER), Duality of Position (DOP), Frequency of Board Meetings (BDMEET), and Board Composition (BODCOMP).

Equation 1 can thus be splitted into three different models, measuring the various constructs identified as follows:

$$\text{EEM} = f(\text{BodStruc}). \tag{1.1}$$

Splitting Equation 3.8 further, we derive Equation 1.2, thus

$$\text{EEM} = f\begin{pmatrix}\text{BodSize, REMCOM, GENDER,} \\ \text{NDOP, FOBodMeet, BodComp}\end{pmatrix}, \tag{1.2}$$

$$\text{EEM} = f\begin{pmatrix}\text{BodSize} + \text{REMCOM} + \text{GENDER} + \\ \text{NDOP} + \text{FOBodMeet} + \text{BodComp}\end{pmatrix}. \tag{1.3}$$

Equation 1.3 can be further represented in econometric form to represent Model 1:

$$\begin{aligned}&\text{EEM}_{it} = \beta_0 + \beta_1\text{BodSize}_{it} + \\ &\beta_2\text{REMCOM}_{it} + \beta_3\text{GENDER}_{it} + \beta_4\text{NDOP}_{it} + \\ &\beta_5\text{BodMeet}_{it} + \beta_6\text{BodComp} + e_{it},\end{aligned} \tag{1.4}$$

where EEM = earnings management proxied by the absolute value of the residual from the performance matched modified Jones model; BodSize = board size; REMCOM = remuneration committee; GENDER = gender diversity; DOP = duality of chairman and CEO position; BodMeet = board meeting; BodComp = board composition; e = residual; Expected a priori = $\beta_1, \beta_2, \beta_3, \beta_5, \beta_6 < 0$, $\beta_4, > 0$.

Thus,
$\beta_1 < 0$, implying that the higher the Board Size, the lower the earnings management practice;

Table 1. Descriptive Statistics.

Item	*n*	*M*	*SD*	Minimum	Maximum
Year	1,096	2,006.5	2.29334	2,003	2,010
Sectid	1,096	3.24818	7.365506	1	24
Coyid	1,096	69	39.56549	1	137
TotalAsset	747	2.37e+08	1.23e+09	389	2.35e+10
Receivables	739	3.07e+07	1.34e+08	249	1.53e+09
PPE	756	1.07e+08	6.95e+08	58	1.45e+10
ROA	747	0.443113	0.2018449	−2.04132	2.263246
Revchange	756	3.31e+07	1.97e+08	−4.43e+08	2.22e+09
Recchange	748	9,255,988	7.00e+07	−4.02e+08	9.61e+08
A	685	9.05e−06	0.0001122	1.00e−10	0.0025707
β1	685	0.6676163	14.20123	−2.052215	371.6122
β2	685	1.794134	27.30369	0.0000379	640.7399
β3	685	0.0518298	0.1996604	−2.04132	2.263246
Dac	685	8.71e−06	0.0001122	−0.0000123	0.002571
Bodsize	685	9.684672	3.175631	0	23
Bodind	685	0.488292	0.135168	0	0.86
BodMeet	685	0.5824818	0.4935102	0	1
Gender	685	0.0571752	0.0791652	0	0.43
RemCom	685	0.1664234	0.3727324	0	1

Source. Field Study.
Note. PPE = plant, property, and equipment; ROA = return on asset.

$\beta_2 < 0$, implying that the higher the availability of Remuneration Committee, the lower the earnings management practice;
$\beta_3 < 0$, implying that the higher the Gender Diversity of the board, the lower the earnings management practice;
$\beta_4 > 0$, implying that the higher the Dualization of Chairman and CEO Position, the higher the earnings management practice;
$\beta_5 < 0$, implying that the higher the Frequency of Board Meetings, the lower the earnings management practice;
$\beta_6 < 0$, implying that the higher the number of nonexecutive board members, the lower the earnings management practice.

This expectation is based on past findings that corporate governance mechanisms should deter earnings management practices in organizations when effectively followed and strictly monitored by the regulators (Bello, 2011; Bugshan, 2005; Murya, 2010).

Descriptive Statistics

The descriptive statistics of the secondary data as gathered from the annual reports of sampled companies presenting the dependent variable (Discretionary Accruals [DAC]) and the independent variables (Corporate Governance Indices) are as summarized in Table 1. The table shows that the period 2003 to 2010 is the study period. The study examined 137 companies from the 24 sectors of the economy.

Table 1 shows that DAC of all the sampled companies has a positive mean of 0.00000871, which means that most of the companies have income-increasing discretionary accruals. Though there are companies with negative discretionary accruals, which means some companies have income reducing discretionary accruals. Income-increasing discretionary accruals are used by managers when earnings are below the forecast, whereas the income-decreasing discretionary accruals are used when premanaged earnings are higher than the forecast to defer these returns for future reports as identified by Murya (2010).

Correlation

Below is the correlation matrix for the model (see Table 2):

$$\mathrm{EEM}_{it} = \beta_0 + \beta_1 \mathrm{BodSize}_{it} + \beta_2 \mathrm{REMCOM}_{it} + \beta_3 \mathrm{GENDER}_{it} + \beta_4 \mathrm{NDOP}_{it} + \beta_5 \mathrm{BodMeet}_{it} + \beta_6 \mathrm{BodComp} + e_{it}.$$

The correlation matrix as presented above shows that there is no high correlation between the dependent variable (Earnings Management), the independent variables, and the control variable. Also, there is low correlation between the independent variables and the control variable. Thus, this is an indication that the regression for the dependent variable and the independent variables can be done. Also, it shows that the control variable has a good fit.

Test for Heteroscedasticity

Heteroscedasticity is the situation in which variance of residuals is not homogeneous. It changes across groups or waves of data. To test for Heteroscedasticity, the Breusch–Pagan

Table 2. Correlation Matrix for Model.

Variable	EEM	Bodsize	RemCom	Gender	Duality	BodMeet	Bodind	ROA
EEM	1.0000							
Bodsize	−.0372	1.0000						
RemCom	−.0295	.1227	1.0000					
Gender	−.0412	.0692	.0248	1.0000				
Duality	−.0251	−.1041	−.0377	−.0214	1.0000			
BodMeet	−.0785	.2241	.3077	.1434	−.1579	1.0000		
Bodind	.0108	.2028	.1900	.1210	−.0961	.2556	1.0000	
ROA	.0339	.0743	.0537	.0412	−.0076	−.0113	.0008	1.0000

Source. Field Study.
Note. EEM = earnings management; ROA = return on asset.

test is used, which is designed to detect any linear form of heteroscedasticity. Breusch–Pagan/Cook–Weisberg tests the null hypothesis that the error variances are all equal versus the alternative that the error variances are a multiplicative function of one or more variables. The bigger the predicted value of Y, the bigger the error variance is. A large chi-square would indicate that heteroscedasticity was present.

Below is the result of the analyses of the heteroscedasticity of the data:
Heteroscedasticity test
Breusch–Pagan/Cook–Weisberg test for heteroscedasticity
H_0: Constant variance
Variables: fitted values of dac
$\chi^2(1) = 4{,}365.51$
$\text{Prob} > \chi^2 = .0000$

The result of the test for heteroscedasticity above shows that the null hypothesis is rejected and the alternate hypothesis accepted, which means that the data set is heteroscedastic in nature. Due to the heteroscedasticity of the data as shown above, and in line with the suggestions of Kim and Imai (2012) on the correction of heteroscedastic data, weight is applied to the regression analysis, and because the data are unbalanced panel data, the fixed effect method of regression is used for analysis. To this end, the weighted fixed effect regression method was used, using the company identifier as the weight; this is as a result of the company characteristics, such as size and turnover.

Hypothesis Testing

The research hypothesis is tested using the E-Views 5 statistical package for the calculation of the annual residuals, which is the discretionary accruals (Earnings Management Measurement); the various models as specified in the previous chapter were measured using the weighted fixed effect regression with the use of the STATA 11 Statistical package for the analyses of the secondary data, whereas the SPSS 15 is used for the primary data.

Research Hypothesis

H_0: Board structure does not have a significant effect on earnings management practices of listed companies in Nigeria.

Using Model 1 as formulated in the previous chapter where

$$\begin{aligned}&\text{EEM}_{it} = \beta_0 + \beta_1\text{BodSize}_{it} +\\ &\beta_2\text{REMCOM}_{it} + \beta_3\text{GENDER}_{it} + \beta_4\text{NDOP}_{it} +\\ &\beta_5\text{BodMeet}_{it} + \beta_6\text{BodComp} + e_{it}.\end{aligned}$$

With reference to the model earlier specified for firm performance, using return on asset (roa) as a proxy for performance. The frequency weight was applied using the company weight outlier as a result of varying company size, samples, and characteristics. The model is significant at 1% level of significance; the regression, therefore, gives the result below (see Table 3).

Table 3 shows the result of the test of hypothesis; it shows that board structure has a significant effect on earnings management practices of listed companies in Nigeria. The result shows that board size has a negative and significant effect on earnings management practices of Nigerian companies at 1% level of significance. This result shows that the higher the board size, the lower the earnings management of Nigerian companies.

The result shows that the presence of a remuneration committee does not have a significant effect on the earnings management practices of Nigerian companies. However, the relationship is positive, which informs that the higher the presence of the remuneration committee, the higher the earnings management practices of companies in Nigeria. This may, therefore, be premised on the independence and the composition of the remuneration committee of Nigerian companies.

The result also shows that there is a negative and significant relationship between gender diversity and earnings management practice of Nigerian companies at 1% level of significance. This, therefore, is an indication that the higher the level of gender diversity, the lower the earnings management practices of Nigerian companies. This, therefore, means the higher the inclusion of women on the board of directors, the lower the earnings management practices in Nigeria. This is in line with the findings of Gulzar et al. (2011).

The result further shows that there is no significant relationship between duality of chairman and CEO positions and earnings management practice of Nigerian companies, although the

Table 3. Tabular Presentation of Results for Board Structure.

Variables	*t* value	*p* > (*t*) significance	Coefficient	*SE*
BodSize	−12.75	.000*	−4.76e−06	3.73e−07
RemCom	0.22	.824	5.91e−07	2.65e−06
Gender	−29.31	.000*	−0.0004482	0.0000153
Duality	0.20	.841	8.18e−07	4.09e−06
BodMeet	8.86	.000*	0.0000216	2.44e−06
BodComp	−2.31	.021*	−0.0000186	8.05e−06
ROA	27.14	.000*	0.0000942	3.47e−06
TA	0.41	.681	3.44e−16	8.37e−16
Constant	17.20	.000*	0.0000864	5.03e−06
No. of observations		45,690		
R^2		Within = .0384		
		Between = .0007		
		Overall = .0018		
sigma_u | 0.00007711				
sigma_e | 0.00011638				
rho | 0.30510688 (fraction of variance due to u_i)				
F test that all u_i = 0: *F*(136, 45545) = 244.77 Prob > *F* = .0000				

Source. Field Study.
Note. ROA = return on asset; TA = total assets.
*Significant at 1% significant level.

relationship is positive, which means the higher the level of duality, the higher the likelihood for companies to manage earnings in Nigeria.

The result shows that there is a positive and significant relationship between the frequency of board meetings and earnings management practices of Nigerian companies at 1% level of significance. This, therefore, shows that the higher the frequency of meetings of board members, the higher the likelihood of earnings management practices of Nigerian companies. This is in line with the findings of Sarkar et al. (2006).

The result further shows that there is a negative significant relationship between board composition and earnings management practices of Nigerian companies at 5% level of significance. This, therefore, is a pointer to the fact that the higher the inclusion of nonexecutive board members on the board of directors, the lower the likelihood that Nigerian companies will engage in earnings management practices. This is in line with the studies of Xie et al. (2003), Murya (2010), Bello (2011), and Uadiale (2012).

Decision: With reference to the result of the test as presented above, the null hypothesis is rejected and the alternate hypothesis accepted, to conclude that board structure has a significant effect on earnings management practices of listed companies in Nigeria.

Conclusion

From the analyses above, it is eminent that like other countries of the world, earnings management is in practice in Nigeria. There is a significant relationship between earnings management practices and corporate governance in Nigeria. It is clear that with appropriate implementation of the contents of the Code of Corporate Governance in Nigeria, financial report credibility can be enhanced and financial integrity of companies in Nigeria achieved. This study concludes that board composition has a negative and significant relationship with earnings management in Nigeria. Thus, there is need for the directorate of corporate governance in the financial reporting council to enforce the rule on large board size as contained in the code. A board size of five may not be appropriate; thus, the minimum board size should be increased. This study also concludes that the independence of the audit committee, gender diversity, establishment of remuneration committee, board independence, and management ownership percentage are all important factors to be considered for effective reduction of earnings management in Nigeria.

Epps and Ismail (2009) identified that firms with annually elected boards, small size boards, have more negative discretionary accruals. However, firms with 75% to 90% independent board or firms with a board size of between nine and 12 have higher positive discretionary accruals. This, therefore, is a pointer to that fact the higher the board size, the lower the earnings management and vice versa. Ghosh et al. (2010), however, found that earnings management does not vary with board composition. This study, however, aims to find out the type of relationship that exists between earnings management and board composition.

Finally, this study concludes that a close monitoring of companies toward full adherence to the contents of the Code of Corporate Governance will serve as a tool for reducing

earnings management practices in Nigeria, which will thereafter enhance the credibility of the financial reports published by the companies, which in turn improves the level of confidence placed on the companies by the investors and the volume of investment in the nation of Nigeria is boosted.

Recommendations

From the findings of the study, the following are the recommendations of the study:

1. Regulatory bodies should consider the enforcement of the contents of the Code of Corporate Governance that affect the board of directors, as they play a major role in the company they represent.
2. Regulators at all levels should enforce the preparation and publication of financial reports by companies as at when due.
3. Accounting professional bodies should engage in in-depth research on the causes and remedies to fraud and unethical practices among their members. This will, therefore, make the professional bodies proactive enough to avoid cases of fraud that may affect the public image of the profession. The accounting professional bodies should also seek for the total independence of the accountants from the directors of the companies, whereby the accountant is employed by an independent body and reports to the same independent body aside from the board of directors.

Authors' Note

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Author Biographies

Imoleayo F. Obigbemi is a scholar and a lecturer in the Department of Accounting, Covenant University.

Eddy O. Omolehinwa is a professor of accounting at the University of Lagos Akoka.

Dick Oluku Mukoro is a lecturer of accounting in the Department of Accounting, Covenant University.

Egbide Ben-Caleb is a researcher and lecturer of accounting in the Department of Accounting, Covenant University.

Olamide Adeola Olusanmi is a scholar and researcher in the Department of Accounting, Covenant University.