OBAFEMI AWOLOWO UNIVERSITY

CORPORATE GOVERNANCE MECHANISMS AND EARNINGS MANAGEMENT OF NON-FINANCIAL FIRMS IN NIGERIA

BY

Latifat Omolara AKANO

ADP13/14/H/0895

A THESIS SUBMITTED TO THE DEPARTMENT OF MANAGEMENT AND ACCOUNTING, FACULTY OF ADMINISTRATION, OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE, NIGERIAIN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTER DEGREE (M. Sc.) IN ACCOUNTING

2016

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

CERTIFICATION

We certifythat this work was carried out byLatifat Omolara AKANOunder thesupervisionofProf.R.O.Salawu,andapprovedinaccordancewiththefulfilmentoftherequirementsf ortheawardofMaster of ScienceDegreeinAccounting ofObafemiAwolowoUniversity,Ile-Ife,Nigeria.

…………………………………… ……………………………………

Prof. R. O. Salawu Date

(Supervisor)

…………………………………… ……………………………………

Prof. D.O. Elumilade Date

(Head of Department)

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

AUTHORIZATIONTOCOPY

OBAFEMIAWOLOWOUNIVERSITY,ILE-IFE, N IGERIA

HEZEKIAHOLUWASANMILIBRARY

POSTGRADUATETHESIS

AUTHOR: Latifat Omolara AKANO

TITLE: Corporate Governance Mechanisms and Earnings Management of Non-Financial Firms in Nigeria

DEGREE: M. Sc.(Accounting)

YEAR: 2016

I,Latifat OmolaraAKANO herebyauthorizetheHezekiahOluwasanmiLibrary,ObafemiAwolowoUniversity,Ile-Ife,Nigeriatocopymythesis,inwholeorinpart,inresponsetotherequestfromindividualresearchersand organizationsforthepurposeofprivatestudyandresearch.

…………………………………..

Signature

……………………………………

Date

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

DEDICATION

To Allah, the Lord of the ‘Alamin.

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

ACKNOWLEDGEMENTS

I give all praise and adorations to almighty Allah, lord of the universe and mankind, for His guidance, assistance and protection throughout the course of this programme.

My profound gratitude goes to my amiable supervisor and academic mentor Prof. R. O. Salawu, I am very grateful for your intellectual guidance, mentoring, painstakingly going through the whole thesis on several occasions. I am indeed very grateful sir.

I want to sincerely appreciate the assistance of the Head of Department; Prof. D. O. Elumilade for his assistance and constant concern for the progress of my thesis. And also to the immediate past H.O.D, Prof. A. A. Agboola, May Almighty God bless you real good sir.

I will also use this medium to specially appreciate the effort of Dr. N. A. Shofoluwe for constantly proof reading this work. May Almighty Allah protect you and your family May HE also grant you your heart desires.

Similarly, my sincere gratitude goes to all the members of staff in the department most especially Prof. T. O. Asaolu, Prof. K.O. Osotimehin, Dr (Mrs) O. O Akinlo, Prof (Mrs) G. O. Akinola, Dr E. Y. Akinkoye, Dr (Mrs) M. K. Salawu, Dr T. J. Ayoola, Dr J. U. Monday, Dr Y.T.Agbaje, Mr. Q. A.Lawal and Mr E. G. Inneh and other lecturers in the department. I thank you all for your useful contributions to this thesis during the seminar. I want to specially thank my late undergraduate supervisor (Mr W. A. Akande) for his encouragement and motivation.The constant smile on his face was always a soothing relief to me, May Almighty God forgive all his sins and make all his children greater than him.

Furthermore, I will like to appreciate the assistance of Mr Rotimi Olowojaiye of English department for his assistance in proofreading this work and the effort of Mr N. O. Oladunjoye of economics department in reading through at short notice.

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

I will forever be grateful to my parents Alhaji Ajao and late (Mrs Akano) for their constant support and prayers during the trying times and for their sacrifices in ensuring that I complete this work and have a sound education. My siblings are not also left out in this regards. I will also like to appreciate the prayers and understanding of my mother in-law (Alhaja G. O. Kareem) and my sister in-laws and their families for their constant support and encouragements during this programme.

I will specially appreciate my husband for his moral and financial support and encouragement throughout this programme. May God never make you lack and lift you up to a greater height.

Lastly, I want to commend the cooperation and understanding of my daughter during the critical and final compilation of this thesis.

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

TABLE OF CONTENTS

TITLE PAGE i
CERTIFICATION ii
AUTHORIZATIONTOCOPY iii
DEDICATION iv
LIST OF FIGURES xi
LIST OF TABLES xii
ABSTRACT xiii
CHAPTER ONE:INTRODUCTION 1
1.1 Background to the Study 1
1.2 Statement of the Problem **Error! Bookmark not defined.**
1.3 Research Questions **Error! Bookmark not defined.**
1.4 Objectives of the Study **Error! Bookmark not defined.**
1.5 Justification for the Study **Error! Bookmark not defined.**
1.6 Scope of the Study **Error! Bookmark not defined.**
1.7 Definition of Terms **Error! Bookmark not defined.**
CHAPTER TWO:LITERATURE REVIEW **Error! Bookmark not defined.**
2.1 Conceptual Review **Error! Bookmark not defined.**
2.1.1 Corporate Governance **Error! Bookmark not defined.**
2.1.2 Corporate Governance and Regulation **Error! Bookmark not defined.**
2.1.3 Importance of Corporate Governance **Error! Bookmark not defined.**
2.1.4 Types of Corporate Governance Mechanisms**Error! Bookmark not defined.**
2.1.5 Earnings Management **Error! Bookmark not defined.**

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

2.1.6 Techniques of Earnings Management **Error! Bookmark not defined.**

2.1.7 Motives behind Earnings Management **Error! Bookmark not defined.**

2.1.8 Control of Earnings Management **Error! Bookmark not defined.**

2.1.9 Features of Earnings Management **Error! Bookmark not defined.**

2.1.10 Types of Earnings Management **Error! Bookmark not defined.**

2.1.11 Real Earnings Management **Error! Bookmark not defined.**

2.1.12 Real Earnings Management in the Post-SOX Period **Error! Bookmark not defined.**

2.1.13 Reasons for Real Earnings Management **Error! Bookmark not defined.**

2.1.14 Types of Real Earnings Management (RM) Activities and Prior Evidence**Error! Bookmark not defined.**

2.2 Theoretical Framework **Error! Bookmark not defined.**

2.2.1 Agency Theory **Error! Bookmark not defined.**

2.2.2 Stewardship Theory **Error! Bookmark not defined.**

2.2.3 Stakeholder Theory **Error! Bookmark not defined.**

2.2.4 Transaction Cost Theory **Error! Bookmark not defined.**

2.2.5 Theory of Information Asymmetry **Error! Bookmark not defined.**

2.3 Empirical Review **Error! Bookmark not defined.**

2.3.1 Corporate Governance and Earnings Management **Error! Bookmark not defined.**

2.3.2 Earnings Management and Performance **Error! Bookmark not defined.**

2.4 Gap in the Literature **Error! Bookmark not defined.**

2.5 Theoretical Framework **Error! Bookmark not defined.**

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

CHAPTER THREE: METHODOLOGY **Error! Bookmark not defined.**

3.1 Research Design **Error! Bookmark not defined.**

3.2 Population, Sampling Size and Sampling Techniques **Error! Bookmark not defined.**

3.3 Sources of Data **Error! Bookmark not defined.**

3.4 Model Specification and Measurement of Variables **Error! Bookmark not defined.**

3.4.1 Influence of Corporate Governance on Earnings Management **Error! Bookmark not defined.**

3.4.2 Impact of Earnings Management on the Performance of Non-Financial Firms in Nigeria **Error! Bookmark not defined.**

3.5 A-priori Expectation **Error! Bookmark not defined.**

3.6 Data Analysis Techniques **Error! Bookmark not defined.**

CHAPTER FOUR: PRESENTATION, ANALYSIS AND INTERPRETATIONS OF DATA **Error! Bookmark not defined.**

4.1 Trend of Earnings Management in non-financial Firms in Nigeria **Error! Bookmark not defined.**

4.1.1 Analysis of Earnings Management in non-financial Firms (2006-2014) **Error! Bookmark not defined.**

4.1.2 Trends of Earnings Management of Sampled Firms **Error! Bookmark not defined.**

4.2 Influence of Corporate Governance Mechanisms and Earnings Management **Error! Bookmark not defined.**

4.2.1 Descriptive Statistics of the Data **Error! Bookmark not defined.**

4.2.2 Correlation Analysis of the Study Variables **Error! Bookmark not defined.**

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact ir-help@oauife.edu.ng

OBAFEMI AWOLOWO UNIVERSITY

4.2.3 Panel Unit Root Test of the Study Variables **Error! Bookmark not defined.**

4.2.4 The Hausman Test of the Study Variables **Error! Bookmark not defined.**

4.2.5 Discussion of findings on the Estimated Cash-Based Earnings Management of Sampled Firms (2006 - 2014) **Error! Bookmark not defined.**

4.2.6 Discussion of findings on the Influence on Corporate Governance on Earnings Management of Non-Financial Firms in Nigeria**Error! Bookmark not defined.**

4.3 Effect of Earnings Management on the Performance of Non-Financial Firms in Nigeria **Error! Bookmark not defined.**

4.3.1 Discussion of Findings on the Effect of Earnings Management on Performance of Non-Financial Firms in Nigeria. **Error! Bookmark not defined.**

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONSError! Bookmark not defined.

5.1 Summary of Findings **Error! Bookmark not defined.**

5.2 Conclusions **Error! Bookmark not defined.**

5.3 Recommendations **Error! Bookmark not defined.**

5.4 Contribution to Knowledge **Error! Bookmark not defined.**

5.5 Limitation of the Study **Error! Bookmark not defined.**

5.6 Suggestion for Further Studies **Error! Bookmark not defined.**

REFERENCES **Error! Bookmark not defined.**

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

LIST OF FIGURES

Figure		Page №
2.1	The Agency Model	42
2.2	The Stewardship Theory	44
2.3	The Stakeholder Model	46
4.1	Trend of Cash-Based Earnings Management of sampled firms	72
4.2	Trend of Cash- Based Earnings Management of sampled firms according to sectors	73

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

LIST OF TABLES

Table		Page №
3.1	Selected Sample Firms by Sectors	64
3.2	Measurement of Variables	69
4.1	Trend analysis of Earnings Management in non-financial Firms (2006-2014)	71
4.2	Descriptive Statistics for Variables of the Study (2006-2014)	76
4.3	Correlation Analysis of Study Variables	78
4.4	Unit Root Test for the variables	79
4.5	Test cross-section random effects	80
4.6	Influence of Corporate Governance on Earnings Management of Non- Financial Firms in Nigeria	84
4.7	Test cross-section random effects	85
4.8	Effect of Earnings Management on the Performance of Non-Financial firms in Nigeria	87

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

ABSTRACT

The study examined the trend and pattern of earnings management;and investigated the influence of corporate governance mechanisms on earnings management of non-financial firms in Nigeria. It also analysed the impact of earnings management on the performance of non-financial firms in Nigeria. These were with a view toproviding information on the influence of corporate governance on earnings management practice in Nigeria non-financial firms.

The study employed secondary data. The study population consisted of 159 non-financial firms listed on the NSE between 2006 and 2014. A sample of 50 firms was purposively selected whose shares were traded during the sampled period and with complete data. Data on board independence, board size, board sex ratio, audit committee independence, board meeting, managerial ownership, ownership concentration, leverage, return on asset and firm size of non-financial firms across sectors in Nigeria were obtained from the Nigerian Stock Exchange factbooks and the companies' annual reports and accounts. Data collected were analysed using percentages, graphs; and fixed effect model technique.

The result of trend analysis of earnings management indicated a non-linear trend with a changing direction of (11.37%, 13.21%, 16.10%, 16.08%, 14.43%, 16.02%, 16.68%, 16.71% and 14.69%) between 2006 and 2014. Also, it showed a fluctuating result with computer and office equipment sector having the highest trend (16.73%), followed by breweries (14.37%), food and beverages (13.91%), oil and gas (12.75%),packaging (11.91%),conglomerates (11.56%), services (11.57%), paints (11.29%) and industrial firms (11.07%).Furthermore, the result showed that board sex ratio ($t = 3.76$, $p < 0.01$), and return on assets ($t = 1.69$, $p < 0.10$) had positive significant influence on earnings management whileboard independence ($t = -2.87$, $p < 0.01$) and managerial ownership ($t = -2.37$, $p < 0.05$) had negative significant influence on

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

earnings management of non-financial firms. In addition, the result revealed that cash-based earnings management ($t = 5.762$, $p < 0.01$),leverage ($t = 2.499$, $p < 0.01$) and size ($t = -7.210$, $p < 0.01$) had significant effect on the performance of non-financial firms.

The study concluded that corporate governance has a significant effect on earnings management of non-financial firms in Nigeria.

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Corporate governance refers to those mechanisms that influence the decisions made by managers when there is a separation of ownership and control. Some of these monitoring mechanisms are the board of directors, institutional shareholders, and operation of the market for corporate control (Larcker, Richardson and Tuna*,* 2015).

Corporate governance has assumed a pivotal position in ensuring stewardship and accountability in the activity of management. The use of corporate governance mechanisms can bridge the gap between the interests of shareholders and managers. Corporate governance has been propagated by different companies' code of conduct which is expected to be included in all firms. It is believed that if there are strong corporate governance mechanisms in place they will reduce the extent at whichthe management of any firm will go on perpetuating any act that can jeopardise the going concern of such firm (Fodio, Ibikunle and Oba,2013).

Recently, a lot of business failures occurred which were as a result of accounting scandals and fraud involving well-known firms such as Enron and World Com (US), One Tel (Australia), Nortel (Canada), Parmalat (Italy), Transmile Group Berhad (Malaysia), and Cadbury(Nigeria). This has informed the need to look into why companies engage in earnings management. These phenomena have reduced the public confidence, most especially in the accounting circles. In addition, there were apprehensions about the weaknesses of corporate governance in the past, and it was not effective enough to protect the investors from expropriation (Uwuigbe, Daramola and Oyeniyi,2014).Thesebusinessfailures were as a result of

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

failure in corporate governance leading to earnings management. The collapse of these companies was aggravated by the absence or theineffectiveness of corporategovernance in place. Also, where there is corporate governance, it is often the case that some of what it embodies in order to have a hitch free firm are not often practised (Uwuigbe *et al.,*2014)

Many countries now review their corporate governance codes to see where it is deficient in order to make correctionswherenecessary so that many areas not capturedby the existing codes will be taken care of (US Sarbanes Oxley Act, 2002; Code for Best Governance Practices, 2005 in Nigeria). Effective corporate governance mechanisms are expected to restore the assurance of shareholders and other users of financial statements of which earnings is a component.

Earnings constitute themost significant accounting items prepared and presented in financial reports and it is considered a major factor in the determination of dividend policy, a guideline for making investment decisions and other decisions; It is a key measure in determining the performance of a firm, an active criterion or prerequisite in the stock pricing and an instrument utilised in making predictions(Gulzar and Wang, 2011, Mohammady, 2012). Earnings management on the other hand, is the adjustment of a firm's reported economic performance by the insiders either to mislead some stakeholders, or to influence contractual outcomes. Earnings management, unlike fraud, involves the selection of accounting procedures andestimates that conform to generally accepted accounting principles (GAAP) (Gulzar and Wang, 2011).That is,firms that have earnings management would be operating within the bounds of acceptedaccounting procedure manipulation (Abdul Rahman and Ali, 2006). The act of managing earnings does not necessarily reflect the true performance of thecompany, a situation that may contribute to shareholders and investors making inaccuratejudgments about the

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

company. Thus, effective board monitoring is important in reducing theincidence of earnings management when incentives for such manipulations are high(Gulzar and Wang, 2011).

The role of corporate governance according to Solabomi and Uwuigbe(2013) is to reduce the divergence of interest between shareholders and managers. It deals with the welfare and goals of all the stakeholders-shareholders, managements, board of directors, lenders, regulators, and the economy as a whole. Thus, in order to protect the rights of the stakeholders, it is vital for an organisation to have effective corporate governance mechanisms which can control the asymmetry of information. The extensive consideration given to corporate governance mechanisms suggests that stronger governance mechanisms would reduce opportunistic management behaviour, thus improving the quality and reliability of earnings management. Corporategovernance (CG) mechanisms repose the confidence of shareholders in earnings reported in the financial statement of a firm (Gulzar and Wang, 2011).Apart from the role of corporate governance in the reduction of earnings management, companies that are perceived as adopting international best corporate governance practices are more likely to attract international investors than those whose practices are perceived to be below international standards (Uadiale, 2012). In an attempt by countries to gain credibility among global investors, sound corporate governance practices are given important attention (Adeyemi and Fagbemi, 2010).

The purpose of earnings management varies and there are different techniques in earnings management.Healy and Whalen (1999) argue that managers mainly manipulate earnings for four kinds of incentives, i.e. external contracts incentives, management compensation contract incentives, regulatory motivations and capital market motivations. The methodsused in earnings management vary from undertaking accounting manipulation or real

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

action that affect operating cash-flows (Barton, 2001).Other methods include manipulation of research and development and sales and leaseback (Matoussi and Kolsi, 2006).

The goal of this study is to examine the effect of corporate governance on earnings management in non-financial firms in Nigeria. Non-financial firms will be of focus due to the vulnerability to governance and reporting abuse as evidenced in the case of Cadbury Nigeria.

For more information, please contact ir-help@oauife.edu.ng

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact ir-help@oauife.edu.ng