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# Corporate Governance and Earnings Management of Quoted Deposit Money Banks in Nigeria

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***Abstract:***
*This research investigated the effect of corporate governance on earnings management of quoted deposit money banks in Nigeria. Research design that is used in this study is the descriptive research and longitudinal method specifically the cohort study. Therefore, from our findings it was drawn that; There is a substantial correlation involving board size composition and earnings management of quoted deposit money banks in Nigeria. There is a substantial correlation involving corporate monitoring quality and earning management of quoted deposit money banks in Nigeria. There is no substantial correlation involving Leadership Structure and earning management of quoted deposit money banks in Nigeria. Thus, the researcher concludes that there is a substantial correlation involving corporate governance and earning management of quoted deposit money banks in Nigeria.*

***Keywords:*** *Corporate governance, earnings management deposit banks*

## 1. Introduction

The current business breakdown in many business institutions has actually resulted in questions in the thoughts of stakeholders on the financial record, integrity and also dependability. The problems of corporate governance and/or business governance as well as earnings management have actually gotten exceptional focus in nearly all fields of the economic system. Dally and Dalton (1999) noted that, corporate industry has actually been dealing with many shifts in this ever-changing ambiance; as a result, bringing about a great deal of abrupt occasions which happened in current periods. These regular shifts made the corporate industry to come out with tools, so as to guarantee much better efficiency as well as the constant development of business. This additionally caused a huge boost in the level of legislations, standards as well as guidelines established in place to improve the requirement of the corporate governance finest procedure. As Swai (2016) observed, the boosting variety of financial crimes as well as corporate breakdowns has actually been triggered by inexperience, deception as well as misuse of workplace by the representatives taking care of the companies. However, earnings management takes place when directors utilize intelligence in financial reporting as well as in building operations to modify financial records to possibly deceive some stakeholders concerning the hidden financial efficiency of the firm or affect legal end results that rely on disclosed accounting numbers (Bala and Kumai, 2015).

Howbeit, there have actually been a number of considerations on the relevance of solid corporate governance in various nations creating various standards and also codes of procedure to sustain governance. The breakdown of company control and authority trigger the appearance of consolidated equity firms that enabled numerous individuals from various places to operate a company collectively. Breakdown of leadership and authority of non-public, governmental firms, stakeholders and various other capitalists' supply of facts concerning their firms' efficiency count greatly on the disclosed fiscal records. It is hard for the stakeholders to anticipate practices and activities of supervisors since supervisors might misstate the records of business tasks delegated to the supervisor by the stakeholders. The business governance is not just suggested for exactly how a firm is guided and regulated, it is regarding and making sure optimal efficiency and liability is maintained to stakeholders; and that, excellent business governance techniques are a must for both nationwide and international economic climates. Olutuyi (2017) argues, a firm that run effectively and sensibly will extremely function well and eventually add value to reinforcing the economic climate. All companies, be it public, personal and charitable company by their numerous execs. It is proper for the regulating body or the boards of supervisors to guarantee excellent corporate or business governance. Owolabi and Dada (2011) observed, a reliable business governance framework assists in stating significant circulation of civil liberties and duties amongst various individuals such as investors, supervisors, board of supervisors and various other stakeholders in a company and additionally helps in highlighting the policies and arrangement of treatments required for choosing on business events. Excellent business governance helps offering a way where a company's goals can be obtained and additionally keeps track of efficiency. More so, the effect of business governance in the fiscal reporting is to view that there is conformity with usually approved audit concept (GAAP) and to keep the integrity of business fiscal declarations. The corporate or business governance devices are the emphasis on

current policies and previous research studies belonging to the company and performance of the board as a whole and its audit committee particularly. Consequently, earnings management is the procedure of taking calculated actions within the restrictions of typically approved accountancy concepts to cause preferred degree of reported earnings (Swai, 2016). In order for a firm to promote their company connection, appropriate interest should be handled when considering earnings. Earnings can be seen as one of the procedures of the success of management in running the business. Nevertheless, a great governance is anticipated to bring about far better corporate efficiency by avoiding the expropriation of managing investors and guaranteeing far better decision-making. This expropriation might be because of the outcome of smoothening of making intent which is called earnings management. With regards to the foregoing, this research is designed to examine the effect of corporate governance and/or business governance on earnings management in down payment cash financial institutions in Nigeria. Thus, deposit money banks in Nigeria. The following questions guided the conduct of this research.

- What benefit do board size and its structure has on earnings management in the down payment cash financial institutions in Nigeria?
- In what way does corporate checking quality influence earnings management in the down payment cash financial institutions Nigeria?
- What benefit does the management framework have on earnings management in the quote down payment cash financial institutions in Nigeria?
- In what way does corporate governance components collectively affect the earnings management in the down payment cash financial institutions in Nigeria?

More so, the following hypothesis in the null form were tested

- Ho1: There is no substantial correlation involving board size and its structure and earnings management in the down payment cash financial institutions in Nigeria.
- Ho2: There is no substantial correlation involving corporate checking quality and earning management in the down payment cash financial institutions in Nigeria.
- Ho3: There is no substantial correlation involving management framework and earning management in the down payment cash financial institutions in Nigeria.
- Ho4: There is no substantial correlation involving corporate governance and earning management in the down payment cash financial institutions in Nigeria.

## 2. Literature Review

### *2.1. Theoretical Foundation*

Pfeffer (1982) in Ibama (2016) observed, every emerging thought in social philosophy is rooted in some fundamental theories, the understanding of which enables their analysis, categorization and easier understanding. With regard to the foregoing, the theoretical foundation which relates corporate or business governance and earnings management in deposit money banks in their operating environment could be to such baseline social/organizational theories such as: agency theory, stewardship theory, stakeholder's theory resource dependency theory and positive accounting theory.

#### 2.1.1. Agency Theory

Agency theory is among the primary concepts of company governance. It was recommended by Stephen Ross and Barry Mitnick in 1970. This theory discusses the relationship that exists between supervisors and investors as an outcome of splitting or breaking up of ownership from control of the modern organization (Hassan and Ahmed, 2012). According to the institute of legal Accountants of England and Wales (2005) in Dibia and Onwuchekwa (2014) notedthat, agency relationship takes place when several principals or proprietor utilize an additional individual to work as their representative or guardian and carry out responsibility on their part. In agency theory, there is always splitting up of ownership and control and this splitting up can be called trademarks of the modern company, utilizing their company's particular expertise and supervisory competence to acquire a benefit over proprietors that are missing from the everyday events of the firm (Dibia and Onwuchekwa,2014).

#### 2.1.2. Stewardship Theory

AssBulle (2014) observed, stewardship theory was established by Donaldson and Donaldson (1991 & 1993) as a brand-new point of view to comprehend the existing relationship between ownership and management of the firm. Stewardship theory acknowledges the significance of frameworks that encourage the guardian and provides optimum freedom. Donaldson and Dayis (1991), explained steward as one that secures and makes the most of investors wide range via firm performance; since by so doing, the guardian's energy features are made the most necessary. More so, stewardship theory minimizes the duality duty of board chair and CEO, recommending that the unified feature encourages the guardian to secure the rate of interest of the investor.

#### 2.1.3. Resource Dependency Theory

Jeffrey Pfeffer and Gerald Salancik (1970) in Ajetumobi (2016) noted, the resource dependency theory is a theory which clarifies that a company depends upon sources from an external resource which impact it corporate governance

frameworks in regards to the calculated management of external relationships along with applying control over such company.

2.1.4. Positive Accounting Theory

Watts and Zimmerman (1990) observed that, positive accounting theory has three theories which encourages earnings management. These theories are (1) Perk Strategy Hypothesis; this is a scenario whereby if a business prepares to offer incentives, supervisors will undoubtedly choose this accounting technique to change benefit from the future right into the here and now to make sure that the present earnings will undoubtedly enhance. This will undoubtedly cause higher bonus offers for supervisors, (2) Equity Theories (debt commitment hypothesis); in the firms having a high financial debts to equity proportion, their supervisors will certainly utilize accounting approaches to raise income or revenues since the firms with high debt to equity proportion have trouble in acquiring extra funds from the lenders and (3) Political Price Hypothesis (size hypothesis); in the firms having a high political price, their mangers will certainly pick the accounting technique to put on hold; the existing duration earnings to following duration and future reported earnings to be chosen political expenditures are built up because high productivity brings in the focus of customers and the media).

*2.2. Conceptual Review*

This research conceptual framework is discussed under the following headings (i) corporate governance (ii) earnings management.

2.2.1. Corporate Governance

The term excellent or good corporate governance was initially presented in 1992 by the Cadbury Committee in its record, called the 'Cadbury record'. The primary objective of the Cadbury Committee on the problem of corporate governance is to obtain a straight concept of managing the business to attain equilibrium between the power and authority of the company in offering liability to the investors mainly and stakeholders. As Shleifer and Vishny (1997) in Dally and Dalton (1999) noted that, noted, Good Corporate Governance provides a means to develop a guarantee to capitalists in getting suitable return financial investments that have been grown. Excellent corporate governance is a collection of regulations that control the relationship between investors, the trustee (supervisor), business, financial institutions, the federal government, staff members, stakeholders, and various other interior and outside relevant to the responsibilities and civil liberties or in different other words a system that manages the business. With regard to the forgoing, the researcher extensively studied the following under corporate governance.

- Board size and composition which entails total board size and board composition,
- Corporate monitoring quality which encompasses audit committee meeting and board independence.
- Leadership structure which covers insider's ownership, ownership concentration and CEO duality

2.2.1.1. Board Size and Composition

According to Bala and Kumai (2015), the size of a firm's board can act as among the essential qualities that can influence the surveillance capability of the board. Amongst the essential obligations of the board of supervisors is to make sure that stakeholders are offered with high-grade disclosures on the monetary and operating outcomes of the entity involved.

2.2.1.1.1. Total Board Size

Beasley (1996) observed the more individuals on the board, the much less reliable guidance of managers and the higher the opportunity of earnings management.

2.2.1.1.2. Board Composition

Studies on board make-up and board management framework has likewise been controlled by a concentration on firm performance (Dally & Dalton,1999), which follows the institutional financial investment neighbourhood needs for even more independent board frameworks. The basic idea is that boards with a higher percentage of nonexecutives/ independent supervisors are generally unbiased in its surveillance feature (Bello, 2011). However, the Nigeria code of corporate governance states some demands for the structure of board participants in firms. The regulation defines that the board ought to be made up in such a means regarding making a certain variety of experience without jeopardizing compatibility, stability, accessibility, and independence. It states that the board must consist of a mix of executive and non-executive supervisors, to be headed by a chairman of the board. Participants of the board ought to be people with upright individual qualities and pertinent core proficiencies, ideally with a document of real success, understanding aboard issues, a feeling of liability, stability, dedication to the job of corporate governance, and organization structure, while additionally having a business prejudice.

2.2.1.2. Corporate Monitoring Quality

The corporate monitoring quality addresses issues on the following such as;

2.2.1.2.1. Audit Committee Meeting

The establishment of audit committee was first suggested in the United States in the late 1930's following the well cited case of 'Mckesson an Robins' but no major development until the 1960's. As Chambers (1998) observed, this

committee is highly needed in checking and controlling financial activities of management. Normally, the audit committee meeting would comprise of three (3) to six (6) non-executive company director who may undertake their duties in rotation and as such, become duly acquainted with the audit function. However, they perform some of the listed responsibilities: (1) to review the effectiveness of accounting and control system: (2) to consider any matter the auditor may wish to bring to the attention of the board of directors; (3) to devote part of its meeting to discussions between external executives serving or the committee.

2.2.1.2.2. Board Independence

This is the percentages of non-executive supervisors on the board to the complete variety of board size. Non-executive supervisors ought to be the participants of the board. They must bring independent judgment in addition to essential analysis to the propositions and activities of the management and executive supervisors specifically on concerns of approach, performance assessment and vital visit (Nigerian SEC code of corporate governance 2010). The firm's board has the responsibility of keeping track of management to shield investors' interest. Thus, the independence of supervisors would certainly minimize the opportunity of economic declaration fraud (Bello, 2011).

2.2.1.3. Leadership Structure

2.2.1.3.1. Insiders' Ownership

According to Parveen, Malik Mahmood and Jan, (2016), insider ownership 1s specified in both methods. The initial method is that, insider ownership can be specified as supervisory ownership; where mangers are offered ownership legal rights as a post-facto motivation device by proprietors. The second one is that insider ownership is specified by the de facto ownership legal rights held by an insider that advertises and likewise takes care of (owner-manager).

2.2.1.3.2. Ownership Concentration

Ownership concentration might minimize agency price by raising, tracking and relieving the free-ride trouble (Parveen, Malik Mahmood and Jan, 2016). From the forgoing, the effective tracking of ownership concentration limits earnings management. As Iturriaga and Hoffmann (2005) and Ali, Salleh and Hassan (2008) noted that, ownership concentration lowers the mangers' discretionary actions. Thus, companies with focused ownership might be subject to disputes of rate of interest between bulk and minority investors.

2.2.2. Earnings Management

There have actually been many interpretations of earnings management. Earnings management describes when the supervisors of a company take advantage of supervisory opinions to change the monetary record, so as to misguide the external investors and all with the intent of acquiring personal gain. As Parveen, Malik, Mahmood, and Jan (2016) observed, earnings management takes place when supervisors make use of judgment in monetary coverage and in structuring deals to modify monetary records to either deceive some investors concerning the hidden financial performance of the firm or to affect legal results that depend upon reported accounting numbers. Thus, earnings management is naturally unobservable.

Generally, there are two kinds of earnings management, they are an accrual-based earnings management and an actual procedure earnings management (Dechow and Skinner, 2000) For the purpose of this study, the researcher shall comment briefly only on the accrual-based earnings management.

2.2.2.1. Accruals

Accrual is defined as the difference between the earnings and cash flow from operating activities. Accruals can be divided in two namely; discretionary accruals and non-discretionary accruals. However, the researcher shall discuss in brief the Discretionary accruals

2.2.2.1.1. Discretionary Accruals

Discretionary accruals are modification to cash flows selected by the management (Parveen, Malik, Mahmood, and Jan, 2016). After calculating total accruals, non-discretionary accruals are subtracted from total accruals to get discretionary accruals. Discretionary accruals symbolize the degree of earnings management. It replicates biased accounting choices made by management. The size of discretionary accruals is indicated as a percentage of assets of a company. The higher the value of discretional accruals, the greater the earnings is maneuverer. In earnings management, income may increase or income may decrease and it depends on accounting choices.

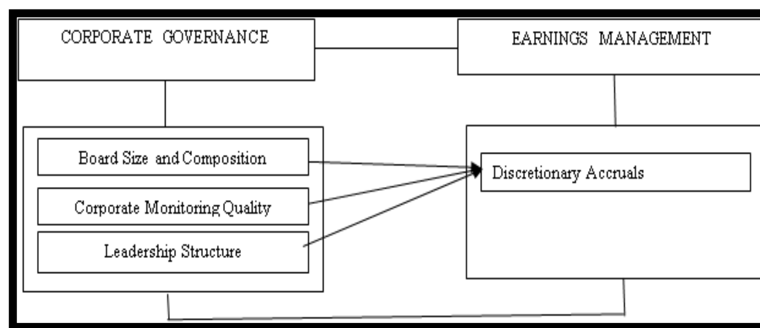


*Figure 1: Operational Conceptual Framework of Corporate Governance and Earnings Management*
*Source: Researches Desk*

2.2.3. Empirical Review

This section of the review of related literature examines other relevant studies as it directly or indirectly relates to the dimension of corporate governance and a measure of earnings management as used in this research.

The works of Owolabi and Dada (2017) set out to study 'corporate governance and earnings management' in both developed and developing countries using different methods. Thus, the problem which necessitated the study focused on how corporate governance affects earnings management. In achieving this, questionnaires and personal interview were used. The study revealed that to elect incumbent board out, the investors would certainly require to mobilize a lot of participants but this procedure is not cost effective; and where there are flaws in the supply of commercial and financial information, it created hazard to efficient corporate governance. They maintained that; the use of external auditors is a means of resolving the detailed information problem. However, this study is different from ours because our study is designed to examine the effect of corporate or business governance on earnings management of deposit money banks in Nigeria, considering board size and composition, corporate monitoring quality and leadership structure as it relates to discretionary accruals.

## 3. Research Methodology

The research methodology used in this study is the descriptive/panel data method. By descriptive it is concerned with the collection and analysis of data for the purpose of describing, evaluating or comparing current or prevailing practices events of occurrences of the selected samples. The study also uses the Panel data because it uses a group of selected deposit-money-banks which makes it a cohort.

## 4. Results and Interpretation

| **Dependent Variable: DCA_**<br>**Method: Panel EGLS (Cross-section Random Effects)**<br>**Date: 08/09/20 Time: 22:51**<br>**Sample: 2015 2019**<br>**Periods Included: 5**<br>**Cross-sections Included: 11**<br>**Total Panel (Balanced) Observations: 55** | | | | |
|---|---|---|---|---|
| Swamy and Arora estimator of component variances | | | | |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
| C | 0.000373 | 0.017431 | 0.021377 | 0.9830 |
| BOSNCOM_ | 0.015318 | 0.003083 | 4.968185 | 0.0000 |
| CMQ_ | -0.226519 | 0.099749 | -2.270897 | 0.0274 |
| LESTR_ | 0.058417 | 0.051428 | 1.135895 | 0.2613 |
| | Effects Specification | | | |
| | | | S.D. | Rho |
| Cross-section random | | | 0.000000 | 0.0000 |
| Idiosyncratic random | | | 0.058677 | 1.0000 |
| | Weighted Statistics | | | |
| R-squared | 0.483915 | Mean dependent var | | 0.075711 |
| Adjusted R-squared | 0.453557 | S.D. dependent var | | 0.075193 |
| S.E. of regression | 0.055584 | Sum squared resid | | 0.157570 |
| F-statistic | 15.94030 | Durbin-Watson stat | | 2.228677 |
| Prob(F-statistic) | 0.000000 | | | |
| | Unweighted Statistics | | | |
| R-squared | 0.483915 | Mean dependent var | | 0.075711 |
| Sum squared resid | 0.157570 | Durbin-Watson stat | | 2.228677 |

*Table 1: Random Effect Test of Regression Analysis Model I*
*Source: Authors Computation Using Eviews (10)*

With respect to table 1, which shows a P-Value (0.0000 and 0.0274<0.05) and (0.2613>0.05) one would say that in testing our hypothesis, Board Size Composition (BSNCOM) has positive significant relationship with Discretionary Accruals (DCA) of deposit money banks in Nigeria, Corporate Monitoring Quality (CMQ) has negative significant relationship with Discretionary Accruals (DCA) of deposit money banks in Nigeria, while Leadership Structure (LESTR) has positive but insignificant relationship with Discretionary Accruals (DCA). Hence, with regard to our Prob(F-statistic) 0.000000 we conclude that there is a significant relationship between Corporate Governance and Earnings management. Thus, our regression graphs are presented below.

## 5. Discussion of Findings

From the results of our data analysis, from Table 1: Random Effect Test of regression analysis Model I, it was shown that there is a significant relationship between Corporate Governance and Discretionary Accruals of deposit money Banks in Nigeria. This is evident from our regression output which indicates a t-stat (4.968185, >2.0 and -2.270897, 1.135895<2.0) which for board size composition is sufficient evidence against the null hypothesis but for corporate monitoring quality and leadership structure it is not, a P-Value (0.0000, 0.0274<0.05 and 0.2613>0.05) and a C-Stat/Coefficient (0.015318, -0.226519, 0.058417) that is to say, that a 2% increase in board size composition, putting in place other corporate governance factor will definitely increase earnings management by 2% and a 22% increase in corporate monitoring quality, putting in place other corporate governance factor will decrease earnings management, and a 5% increase in leadership structure, putting in place other corporate governance factor will definitely increase earnings management by 5% of which from the probability value it is insignificant. Hence, from the above it makes Corporate governance to reduce the effect of earning to be reported in an inappropriate manner. More so, from our empirical study the outcome is almost in line with the works of Diba and Onwuchekwa (2014) who studied the appraisal of Corporate-governance mechanisms and Earning-Management in Nigeria, and

## 6. Conclusion

The conclusion drawn from these findings is that corporate governance remains relevant in mitigating earnings management. But the structure of corporate governance practice in the market-based system of corporate governance impacts positively on earnings management. In this system, the line between corporate governance and management is so blurred, such that corporate boards functions: control and supervision, oversight and performance monitoring are rendered meaningless. This being the case, corporate governance in the market-based system appears by and large, to have been incapacitated by the merged relationship between the board and management especially in the banking industry. It is fairly difficult to determine where management ends and corporate governance functions starts in the market-based system with its single tier board of directors.

For instance, executive directors together with senior management sit on boards of Nigeria banks. This none separation of powers of boards from those of management could explain the relationship between board size (BSNC) and Earnings Management irrespective of which variable is used to it. More so in line with the research which studies the relationship between Corporate governance and earnings management one would conclude that irrespective of the fact that each corporate governance parameters independently has a relationship with earnings management one would have to consider bringing all variable or measure into play as they all work together to form good Corporate governance and hence cannot work independently of each other hence earnings management will not be able to be mitigated.

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