EFFECT OF CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT OF LISTED DEPOSIT MONEY BANKS (DMBS) IN NIGERIA

Godwin David
Department of Accounting,
Nuhu Bamalli Polytechnic, Zaria.

Mark David Kantiyok
Department of Accounting,
Nuhu Bamalli Polytechnic, Zaria.

Elisha Williams Baba
Department of Business Administration & Management,
Nuhu Bamalli Polytechnic, Zaria.

ABSTRACT
This study assesses the effect of corporate governance mechanisms on earnings management of listed deposit money banks in Nigeria for a period of five years (2015-2019). The study adopted a correlation research design in a sample of five Deposit Money Banks (DMBs) listed on the Nigeria Stock Exchange (NSE). Panel multiple regression techniques were used for data analysis and the study found that board size and board independence have a significant statistical positive effect on the earnings management (measured by Discretionary Loan Loss Provision (DLLP)) of listed DMBs in Nigeria. The findings also revealed that audit committee independence and gender diversity has negative but insignificant and positive but significant effect on the earnings management of the listed DMBs in Nigeria respectively. Hence, the study recommends among others that, there is the need for effective corporate governance practices in DMBs in Nigeria. It is also recommended that the number of board of directors’ members should be increased to a maximum size of twenty as provided by the CBN Code of Corporate Governance for Banks.

Keywords: Corporate Governance, Board Size, Earnings Management, Banks

Introduction
Corporate failures, financial crises worldwide and collapse of some high profile companies have raised questions on the integrity and credibility of corporations, financial institutions and markets about maintaining investor’s confidence, economic activities and the protection of shareholders. The studies of issues related to corporate governance have reported inconsistent findings on the effect of corporate governance on earnings management. The recent collapse of some of the largest companies globally resulting partly from accounting manipulations has raised serious concern about the effectiveness of different monitoring mechanisms organizations explored. The main aim of corporate governance is to ensure that businesses are managed with a view of maximizing profit and at the same time delivering returns to different stakeholders.

Earnings management occurs when managers use discretion in financial reporting and in structuring transactions to alter financial reports to give false information to some stakeholders about the actual performance of the business or to influence contractual outcomes that depend on reported accounting figures. Accounting practices that are aiding earnings management make corporate governance to
gain importance since the focus is on shareholders and other users of accounting information. This has also attracted increased public and academic debates on issues related to the effectiveness of the boards of directors particularly on issues concerning the earnings management of firms. The concerns on the inefficiencies of organization necessitate the use of corporate governance since it serves as one of the top controls mechanisms in a corporation. The corporate governance mechanisms functions have the potentials to reduce managerial opportunistic behaviour and serves as a source of corporate monitoring.

Hence, good governance is expected to ensure good performance and minimizes earnings management tendencies. This relationship has recently attracted considerable attention in the financial management literature both in Nigeria and at international level (Hassan & Ahmed, 2012). In Nigeria for instance, corporate failures have been experienced due to weak corporate governance mechanisms within the banks (Ifeanyi, Olagunju & Adeyanju, 2011). Their survey confirms that corporate governance lapses were significantly responsible for the collapse of over 70% of dormant companies in Nigeria over the last two decades. They found that market share, volume of turnover and asset size is less potent relative to sound corporate governance for the survival of a business. Some of the banks in Nigeria which have experienced corporate failures as a result of poor corporate governance practices include Intercontinental Banks, Oceanic Bank, BankPHB, Afribank, Spring Bank, Societe Generale Bank collapse between 2008-2014.

However, many empirical studies were conducted to determine the relationship between corporate governance mechanisms and earnings management, but the findings are mixed. The current study intends to use the most recent data from Nigeria after the release of separate code of corporate governance for banks in 2006. Few studies have exactly assesses the effect of corporate governance on earnings management of listed Deposit Money Banks in Nigeria over the period 2015 to 2019. Most existing works in this area was tailored to general effect of corporate governance on performance of a firm or on specific corporate governance proxy and earnings management. Therefore, this study seeks to examine the effect of corporate governance on earnings management in Nigerian Banks.

**Objectives of the Study**

The main objective of this study is to assess the effect of corporate governance on earnings management of listed deposit money banks in Nigeria. The specific objectives of the study are as follows:

i. To assess the effect of board size on earnings management of listed deposit money banks in Nigeria.

ii. To assess the effect of board independence on earnings management of listed deposit money banks in Nigeria.

iii. To assess the effect of audit committee independence on earnings management of listed deposit money banks in Nigeria.

iv. To assess the effect of gender diversity on earnings management of listed deposit money banks in Nigeria.
Research Hypotheses
Based on the research objective, the following hypotheses are formulated in null form;

H01: Board Size has no significant effect on the earnings management of listed deposit money banks in Nigeria.

H02: Board Independence has no significant effect on the earnings management of listed deposit money banks in Nigeria.

H03: Audit committee independence has no significant effect on the earnings management of listed deposit money banks in Nigeria.

H04: Board gender diversity has no significant effect on the earnings management of listed deposit money banks in Nigeria.

Literature Review and Theoretical Framework
Corporate governance refers to the process that seeks to direct and control the affairs of an organization, so as to protect the interest of all stakeholders in a balanced manner with application of the principles of openness, integrity and accountability (Obeten, Ocheni & John, 2014). Gabrielsen, Gramlich and Plenborg (2012), also defined corporate governance as all encompassing - it concerns the manner in which corporate entities are managed and regulated, and involves accountability, trust, honesty and stewardship on the one hand and supervision, control, monitoring, oversight and ensuring quality financial reporting on the other hand. Demaki (2011), Corporate governance is an institutional arrangement that checks the excesses of controlling managers. The whole essence of corporate governance is to ensure that the business is run well and investors receive a fair return (Kajola, 2008).

The positions of the writers on the subject matter point to the fact that, our organizations have deepened themselves in unethical practices which is a big concern to all. Therefore, whole essence of corporate governance is to ensure that organizations carry out their operations in an open, sincere and transparent manner that will not cast any ray of doubt on the customers and stakeholders.

According to the Cadbury Committee Report (1992), corporate governance is the system by which business corporations are directed and controlled. Board of directors is responsible for the governance of their companies. The shareholders’ role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

The business environment has faced radical changes, and this has been reflected in the emergence of many complicated financial transactions, which made management to find ways to control accounting information to meet these new circumstances, by using various interpretations and multiple alternatives and methods, to be acceptable and consistent with accounting standards. This has opened the door for management to manipulate and circumvent financial reports about their firm’s financial performance to present a better image to investors and shareholders through what has become known as "earnings management", “creative accounting practices” or “income smoothing”.

These practices have sometimes resulted in undesirable consequences for companies, such as Enron, (Mohammed & Abdel, 2017). The new phenomenon which is known as "earnings management" is practiced by managers to improve their company’s profitability and financial position that is published in financial reports. They also use such practices to satisfy shareholders wants, or to limit a decline in their company’s share prices traded on financial markets, or to avoid compulsory liquidation (Mulford & Comsikey, 2005).
There are different concepts for earnings management. Earnings management is sometimes known as “cooking the books” (Moss, 2016). Furthermore Schipper (1989) defined earnings management as a deliberate intervention in the financial reporting process to achieve private goals. He also defined it as a conduct that is carried out by management to influence the cash flows that occur in income to address the deviations which are not normal, through the selection of certain accounting policies. It means that managers make financial transactions that would conceal the underlying value of the company or influence the allocation of resources. Barton (2001) defined earnings management as the use of accounting techniques to produce financial statements and records that paints an exaggerated positive picture of a firm’s business activities and financial position.

**Review of Empirical Studies**

There are several studies on corporate governance and earnings management that have been undertaken internationally and in Nigeria. For example, Barton (2001) investigated the relationship between earnings management and board structure. The results revealed that earnings management was negatively related to board size and composition. Wangaruro (2014) studied the effect of corporate governance practices on earnings management for the listed commercial banks in Kenya. The findings depicted that earnings management is negatively related to board size and board composition. Peace and Elewechi (2015), studied the relationship between corporate governance and earnings management, based on evidence produced from the accounts of listed companies in one of Africa's largest economies, Nigeria. The results revealed there is a positive significant relationship between the size of the board, return on assets and earnings management. Musyoka (2015), studied the effect of board structure on earnings management of companies listed at the Nairobi Securities Exchange. The study found that size of the board and board independence negatively affects earning management among firms listed in the Nairobi Securities Exchange. Abdulazeez, Ndibe and Mercy (2016) studied the impact of corporate governance on the financial performance of all listed deposit money banks in Nigeria for a period of seven (7) years (after consolidation). It was found that larger board size contributes positively and significantly to the financial performance of deposit money banks in Nigeria.

Imoleayo, Eddy and Dick (2012) evaluated the role corporate governance plays in curtailing earnings management practices in Nigerian companies. The study shows that there is a significant relationship between board structure and earnings management practices in Nigeria. Hyejeong and Su-In (2018) investigated whether corporate governance mechanisms are associated with earnings quality, especially accurate earnings reporting, and whether investors react differently to inaccurate earnings according to governance strength. The study found that, the gap between unaudited earnings and actual earnings is smaller for firms with independent board and foreign ownership, suggesting that earnings accuracy is higher for firms with effective corporate governance. This study also examined how investors react to the earnings gap. Stock returns to the earnings gap are less negative for firms with independent boards and are more negative as foreign ownership increases, implying that each mechanism of corporate governance has different effects.

Xie, Davidson, and DaDalt (2003) studied the relationship between earnings management and corporate governance. The findings depicted that there was a significant negative relationship between earnings management and the percentage of outside directors and board committee number of meetings. Bedard, Chtourou, and Courteau (2004), examined the relationship between the measures of earnings management on the independence of audit committees. The study found a
significant negative relationship between measures of earnings management and independent audit committees. Mathew and Stephen (2016) investigated the effect of corporate governance variables on earnings management among selected listed firms from the manufacturing and banking sectors. Employing the panel data analysis approach, board independence, audit committee independence and audit committee size are insignificantly positively correlated with earnings management. On the other hand, Musyoka (2015) studied the effect of board structure on earnings management of companies listed at the Nairobi Securities Exchange. The study revealed that the size of the board, board independence, board activity, gender diversity, age diversity, ethnic diversity and financial leverage strongly affect earnings management among firms listed in the Nairobi securities Exchange.

This study is therefore underpin by the agency theory, which brings out a clear exposition of the actions of some managers which and led to the agency problem. The managers’ conflict of interest as agent of the owners makes shareholders’ wealth maximization objective to be ignored through earnings management practices. Agency theory according to Meckling and Jensen (1976) is a contractual relationship in which the principal engage the agent to perform services on his behalf which involves delegating decision making authority to the agent. According to the agency conflicts hypothesis, the ability of managers to distort information and manipulate earnings depends on the firm's degree of organizational complexity and on the potential for agency gains which may prove to be highly important. Large firms with complex organizations and agency problems are diversified across more than one country or industry. In addition, they are likely to exhibit agency conflicts and informational asymmetry problems which are considered conducive to the practice of earnings management.

Methodology
The study employed correlation research design. This is because it studies cause and effect, which also provides basis to examine the relationship between corporate governance and earnings management of listed DMBs in Nigeria. The population of this study includes all the Fourteen (14) Deposit Money Banks listed on the Nigeria Stock Exchange (NSE) as at 31st December, 2019. The population are Access Bank Plc, Ecobank Plc, Guaranty Trust Bank Plc, First City Monument Bank Plc, Fidelity Bank Plc, First Bank Nigeria Plc, Skye Bank, Stanbic IBTC Bank Plc, Sterling Bank Plc, Union Bank Nigeria Plc, United Bank for Africa Plc, Unity Bank Plc, Wema Bank Plc, and Zenith Bank Plc. The sample size of the study is Five (5) banks, which was chosen using simple random sampling technique. The sample banks are the Guaranty Trust Bank Plc, First City Monument Bank Plc, Sterling Bank Plc, United Bank for Africa Plc and Zenith Bank Plc.

Secondary data was obtained from annual reports and accounts of the sampled firms, both financial and non-financial information such as the number of directors, proportion of executive and non-executive directors in the board, proportion of executive and non-executive directors in the audit committee and the number of male and female directors in the board was used. The study employed panel multiple regression technique of data analysis, which was used to estimate the research model with the aid of STATA in order to establish the relationship between corporate governance and earnings management and also to estimate the regression equation under consideration.

Variables and Measurement and Model Specification
The variables of the study; dependent variable (earnings management) and the independent variables corporate governance are measured in this section as presented in table 1.
<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Variable Measurement</th>
<th>Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dependent Variable</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earnings Management</td>
<td>Is measured as the sum of the ending balance of allowance for bad and doubtful debts and loan charge-offs, less the beginning balance of allowance for bad debts</td>
<td>Chang, Shen, and Fang (2008)</td>
</tr>
<tr>
<td>(Discretionary Loan Loss Provision (DLLP))</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Independent variables</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board Size</td>
<td>Is measured as the total number of directors on the board.</td>
<td>Uwalomwa, Daramola and Anjolaoluwa (2014)</td>
</tr>
<tr>
<td>Board Independence</td>
<td>Is measured as the proportion of non-executive directors to total directors</td>
<td>Matthew and Stephen (2016).</td>
</tr>
<tr>
<td>Audit Committee Independence</td>
<td>Is measured as the proportion of non-executive audit committee members to the total number of audit committee members</td>
<td>Matthew and Stephen (2016).</td>
</tr>
<tr>
<td>Gender Diversity</td>
<td>Is measured as the absolute number of female directors on the board</td>
<td>Musyoka (2015).</td>
</tr>
</tbody>
</table>

**Source: Researcher**

The study has two models; the first model was used to measure earnings management based on Chang et al (2008), while the second model was used to determine the effects of corporate governance on earnings management. Earnings management of banks was estimated as a function of corporate governance by Board Size (BS), Board Independence (BID), Audit Committee Independence (ACI) and Gender Diversity (GED). The econometric models is mathematically expressed as follows;

$$LLPi/TAt-1 = \alpha_0 + \alpha_1 LCOi/TAt-1 + \alpha_2 BBALi/TAt-1 + \mu_i$$

Where:

- LLP is Loan Loss Provision for firm i at time t;
- LCO is the Loan Charge-offs for firm i at time t;
- BBAL is the beginning balance of LLP for firm i at time t;
- TA is the beginning total asset of firm i at time t;
- $\mu_i$ is the error term;
- $\alpha_0$ is the intercept; $\alpha_1$ and $\alpha_2$ are parameter estimates of the variables.

The Discretionary Loan Loss Provision from model one is used in model four as a proxy for earnings management.

$$EM = f(CG)$$

$$EM = f(BS, BID, ACI and GED)$$

$$EM = \beta_0 + \beta_1 BS_{it} + \beta_2 BID_{it} + \beta_3 ACI_{it} + \beta_4 GED_{it} + \epsilon_{it}$$

Where:

- EM is Earnings Management;
- BS is Board Size;
- BID is Board Independence;
- ACI is Audit Committee Independence;
- GED is Gender Diversity;
- $\beta_0$ is Regression Intercept; $\beta_1$, $\beta_2$, $\beta_3$ and $\beta_4$ are Parameters to be estimated; $\epsilon$ is Error term; it is Bank i in year t.
Results and Discussion

Descriptive Statistics
The descriptive statistics provides the summary of the data in terms of minimum, maximum, mean and standard deviation of the data for the variables used in the study, as presented in table 2.

Table 2: Descriptive Statistics

<table>
<thead>
<tr>
<th>Variables</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>EM</td>
<td>0.0253</td>
<td>0.4814</td>
<td>0.3092</td>
<td>0.1288</td>
<td>25</td>
</tr>
<tr>
<td>BS</td>
<td>10.000</td>
<td>19.000</td>
<td>14.560</td>
<td>2.6627</td>
<td>25</td>
</tr>
<tr>
<td>BID</td>
<td>0.4286</td>
<td>0.9091</td>
<td>0.6457</td>
<td>0.1404</td>
<td>25</td>
</tr>
<tr>
<td>ACI</td>
<td>1.3333</td>
<td>2.6667</td>
<td>1.9733</td>
<td>0.2531</td>
<td>25</td>
</tr>
<tr>
<td>GED</td>
<td>0.0000</td>
<td>0.4118</td>
<td>0.1945</td>
<td>0.1282</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: STATA Output

Table 2 presents and shows the detail of the accounts of descriptive statistics for the explained variable (EM) and explanatory variables board size (BS), board independence (BID), audit committee independence (ACI) and gender diversity (GED). It is clear that there is moderate variation between the standard deviation and the mean.

From the output in the table, earnings management (EM) has the minimum and maximum value of 0.0253 and 0.4814 respectively, while the mean value of 0.3092 as well as the standard deviation value of 0.1288. The standard deviation indicates the movement of the earnings management between the minimum and the maximum, the higher the value of the standard deviation the higher would be the rate of deviation from the mean.

Similarly, the table indicates that the board size of the sampled banks in Nigeria has an average value of 15 members (from the mean value 14.560) and the standard deviation of 2.6627 and minimum values of 10, and the maximum of 19 members. Also, table 2 shows that the mean of the board independence of the sample banks in Nigeria is 0.6457 with the standard deviation of 0.1404, and minimum value of 0.4285 and maximum value of 0.9091, this shows that board independence of the sample banks is on average 64.57%, and the maximum is 90%.

The table also indicated that the mean of the audit committee independence is 1.9733, while the standard deviation is 0.2531. The minimum value is 1.3333 and maximum value of 2.6667 for the sample banks. The value of standard deviation shows how the sample banks deviate from both side of the mean by 0.2531. Table 2 shows that the mean value of board gender of the sampled banks is 0.1945 which indicated a moderate dispersion of the data from the mean value. The minimum of 0 and maximum of 0.4118, this implies that the minimum and the maximum of women representation on the board. This shows that gender of the sampled banks deviates from the mean value from both sides by 0.1282.

Correlation Matrix

The relationship between the explained and explanatory variables of the study is presented in table 3;

Table 3: Correlation Matrix

<table>
<thead>
<tr>
<th>Variables</th>
<th>EM</th>
<th>BS</th>
<th>BID</th>
<th>ACI</th>
<th>GED</th>
</tr>
</thead>
<tbody>
<tr>
<td>EM</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The results in table 3 shows the degree of association between earnings management (EM) and all the independent variables in the sampled banks. The table presents a positive relationship between (EM) and board size (BS) from the correlation coefficient of 0.3847. This relationship implies that the board size affect earnings management in a positive direction. Table 3 shows that there is negative association between EM of the sampled banks and board independence (BID) of the sampled banks, from the correlation coefficient of -0.0699. This relationship implies that the number of independent board members affects earnings management in negative direction.

Moreover, the table indicates a positive correlation between EM and audit committee independence (ACI) from the correlation coefficient of 0.0124. This relationship implies that as the number of independent audit committee members increases the earnings management (EM) is decreasing. The table also, indicates a positive association between EM and gender (GED) from the correlation coefficient of 0.4163. The analysis of the relationships between dependent variable EM and all the independent variables and between independent variables themselves indicated that some are positive and some are negative.

Regression Results and Hypothesis Testing
In this subsection, the regression result from which the research hypotheses are tested are presented in table 4.

Table 4: Summary of Regression Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>Beta Coefficient</th>
<th>t-values</th>
<th>Sig</th>
<th>VIF</th>
<th>1/VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>BS</td>
<td>0.0342</td>
<td>2.64</td>
<td>0.016</td>
<td>2.79</td>
<td>0.3584</td>
</tr>
<tr>
<td>BID</td>
<td>0.8772</td>
<td>3.28</td>
<td>0.004</td>
<td>3.31</td>
<td>0.3017</td>
</tr>
<tr>
<td>ACI</td>
<td>-0.0358</td>
<td>-0.40</td>
<td>0.693</td>
<td>1.21</td>
<td>0.8281</td>
</tr>
<tr>
<td>GED</td>
<td>0.6828</td>
<td>2.76</td>
<td>0.120</td>
<td>2.37</td>
<td>0.4215</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.8173</td>
<td>-2.06</td>
<td>0.052</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The multiple coefficient of determination indicated that the independent variables (board size, board independence, audit committee independence and gender diversity) explained about 38.47% of total variation in the dependent variable, earnings management of Deposit Money Banks in Nigeria. Table 4 further indicates that the model is fit, variables properly selected, combined and used in the study. This is statistically supported by the F-Sig (0.0074) with a coefficient value of 4.75.
Table 4 also shows that the multicollinearity test using the tolerance value and variance inflation factor (VIF), there is no perfect multicollinearity as the value of the VIF is less than 10 and the tolerance value is more than 0.1. This shows that the model fits the study very well. The table also shows the absence of heteroscedasticity, from the chi-square value of 0.03 and the p-value of 0.8738, which does not violate the assumption of constant variance. Therefore, this suggests that the panel elements are homoscedastic and the OLS result is preferred or favored.

From the table, it is observed that the board size and board independence was found to be significant at 5% and 1% respectively. This signifies that board size, board independence have a significant positive effect on earnings management of deposit money banks in Nigeria. Therefore, the study rejects the null hypotheses one (H01) and two (H02). The result from the table also shows that the audit committee independence has an insignificant negative effect on earnings management, while gender diversity have an insignificant positive effect on earnings management. The study therefore failed to reject the null hypotheses three (H03) and four (H04) respectively. Overall, the study reject the null hypothesis that, corporate governance has no significant effect on the earnings management of listed Deposit Money Banks in Nigeria.

The findings of the study revealed that board size and board independence have positive and significant effect on the earnings management of listed DMBs in Nigeria while audit committee independence and gender diversity has negative but insignificant and positive but insignificant effect on the earnings management of the of listed DMBs in Nigeria respectively. This is consistent to the study of Imoleayo, Eddy and Dick (2012) and Peace and Elewechi (2015).

**Conclusion and Recommendations**

The study examines the effect of corporate governance mechanisms on earnings management of listed Deposit Money Banks in Nigeria from 2015 to 2019. Emanating from the findings, the study concludes that, larger board size have direct relationship with earnings management than smaller board size. The proportion of non-executive directors serving in the boards of banks is higher than the executive directors and this is in compliance with the specification of corporate governance code. And that, board independent also have a direct relationship with earnings management. The study also conclude that audit committee independence and gender diversity have an insignificant relationship with earnings management.

Sequel to the findings and conclusion of the study, it is recommended that, banks should increase the number of board of directors to maximum size of twenty directors as provided by the CBN Code of Corporate Governance 2014. Board independence should consistently be the focus of management, as it influences the earnings management.

**References**


OECD, (2004). Principles of Corporate Governance. OECD Publications, 2, Rue André-Pascal, 75775 Paris Cedex 16 Printed In Franc


