RESEARCH ARTICLE

# Regulatory Changes, Board Monitoring and Earnings Management in Nigerian Financial Institutions

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**Abstract:** This paper explores the heterogeneity of board of directors and shareholders involvement in the audit committee in addressing the question of whether the board of directors and audit committee shareholders are effective in suppressing earnings management after the implementation of 2011 revised Code of Corporate Governance in Nigeria. The paper utilized data generated after the implementation of the new Code. It examines explicitly board effectiveness and audit committee shareholder chairman on earnings management in Nigerian financial institutions. The study utilizes a dynamic panel data model of the generalized method of moment (GMM) in analyzing the data. The empirical results suggest that board independence and shareholders as audit committee chair play an essential and a significant negative relationship in curving earnings management. Specifically, the results show that shareholders played effective roles in chairing the audit committee and suppressing the magnitude of earnings management. The results affirmed that the Big 4 relates to lower earnings management. Regulators should consider increasing the number of years shareholders representatives are to serve in the audit committee to continuously improve the quality of the financial reporting process and suppress managers' opportunistic behavior.

*Keywords*: board of directors, shareholders, earnings management

*JEL Classifications:* G3, M42

The critical issue surrounding accounting research in today's business world is the magnitude to which managers change reported earnings for their selfish interests (Mostafa, 2017). The flexibility of corporate financial reporting using the Generally Accepted Accounting Principles is widely thought to avail managers with a leeway to manage earnings in an opportunistic manner which, as a result, affect the quality of reported earnings (Ghazali, Shafie, & Sanusi, 2015; Xie, Davidson, Dadalt, 2003)

Consequently, earnings management (EM) disguises when managers attempt to manage earnings selfishly to raise their wealth. Thus, EM conceals the firms' actual and true economic performance and hides valuable information that users of financial information should have seen (Dechow & Skinner, 2000; Hu, Hao, Liu, & Yao, 2015). Board with outside directors and high reputation is, therefore, an essential ingredient of corporate governance mechanism that can institute good corporate practice and protects the best interest of shareholders by suppressing managers' opportunistic behavior and ensure adequate investment return (Fama & Jensen, 1983; Mansor, Che-Ahmad, Ahmad-Zaluki, & Osman, 2013; Moradi, Valipour, & Pahlavan, 2012). The functions of the board are achieved through various sub-committees established by it, one of such committees is the audit committee (Al-matari, Homaid, & Alaaraj, 2016; Haldar & Raithatha, 2017).

In recent time, the audit committee is arguably considered as part of the corporate governance structure of a firm which is the most critical and challenging sub-committee of any firm's board of directors (Ghafran & Yasmin, 2018). It is seen as a custodian of a firm's financial integrity (Rezaee, 2005) and can enhance financial reporting quality by reviewing the financial statements on behalf of the board (Aldamen, Duncan, Kelly, McNamara, & Nagel, 2012). The failure of Enron in 2001 and several others initiated additional and essential sets of audit committee regulation both in the U.S. and all over the world. In the U.S., for example, the most precise response was the promulgation of (Sarbanes-Oxley Act of 2002), which focused on the security of investors and instilling of confidence in the financial markets (Coates, 2007). To achieve its objective, a critical governance mechanism offered by the Act was the formation of inspired audit committees. Nigeria's response was the release of 2011 Revised Code of Corporate Governance with an invigorated

audit committee that includes shareholders as members (Securities and Exchange Commission [SEC], 2011).

Thus, this study is motivated by the inclusion of shareholders in the audit committee consequent upon irregularities and accounting fraud that led to the crash of various firms in Nigeria. The inadequate disclosure provisions of the defunct Nigerian Accounting Standards and audit committee's (AC) poor performance were among the reasons that necessitated the regulatory changes which saw the release of new Corporate Governance Code in 2011 (Adegbite, 2012; SEC, 2011). The involvement of shareholders to sit in the audit committee is another strong motivation, as the 2011 Revised Code has placed more prominence on audit committees. Hence, the committee's workload has grown significantly with a broad set of responsibilities that need grave attention in every facet of their work (Ghafran & Yasmin, 2018; Mohammed, Che-Ahmad, & Malek, 2018).

The Code of Corporate Governance (the Code) was issued on April 1, 2011. The new Code stresses the inclusion of at least one member of the audit committee with financial expertise. The Code further recommends that at least one member of the audit committee should also be independent (Abdulmalik & Che-Ahmad, 2015). Overall, the composition of the audit committee should be an equal number of three directors and three representatives of shareholders as enshrined in Section 359(3&4) Companies and Allied Matters Act [CAMA], (2004) and part E article 30 of SEC, (2011). The Code has also recommended the separation of the role of chairman and the chief executive officer. Additionally, Part C article number 27 of the new Code has empowered institutional investors to monitor the affairs of the companies through representation on the board. The board size should not be less than seven for the banking sector and should not be greater than 10 for insurance. However, the banks have the discretion to determine the board size according to their individual needs. The Code also recommends the establishment of a corporate governance committee, risk management committee, and whistle blowing policies to enhance and strengthen the financial reporting process.

Although the Code makes adequate provisions to raise investors' trust in the capital market, compliance with the Code remains voluntary up to the year 2013. Consequent upon the lack of

compliance by most of the companies, the Code became mandatory in 2014 through part 1 article 1b (1) of the Code of Corporate Governance for Public Companies as amended in 2014 and issued by the (Securities and Exchange Commission [SEC], 2014). Also, the Code has made a provision of N500,000.00 fine for any firm that violate any of the Codes and an additional sum of N5,000.00 for each day the violation continues under article 1(c). The Code further states that it is the responsibility of the board to ensure performance and will be held liable for compliance under article 2(1-3).

Most previous studies deal on board characteristics and audit quality on EM of non-financial institutions (Klein, 2002; Okolie, 2014a; Ujunwa, 2012; Xie et al., 2003). Moreover, limited studies on the financial institution's board characteristics and audit quality have seemingly conflicting and contradictory results. Conversely, studies on a financial institution in an emerging economy such as Nigeria are in the neglect despite their importance (Gbandi & Amissah, 2014). Consequently, this present study focused on financial institutions due to their patterns of EM which may be different from non-financial institutions as a result of high regulation, substantially more leveraged and more opaque (Elyasiani, Wen, & Zhang, 2017).

Additionally, financial institutions are drivers of the economy which serve as debtors to economic units and play a vital intermediary role to avoid "financial pollution" that can cause ineptitudes in the financial markets (Chude & Izuchukwu, 2014; Filip, 2015; Zeng, 2012). These financial institutions operate within an external business surrounding with unified corporate governance regulations that shape and control their operations (Ahmad & Bashir, 2013). Further, the external business atmosphere consists of macroeconomic factors such as political, environmental, technological, social, and legal that affect and shape the activities of these institutions and the financial markets (Filip, 2015). Hence, examining earnings management in this important sector is apt and timely in the wake of new reporting language (Zango, Kamardin, & Ishak, 2015).

In this present study, we examine the relation of a range of board of directors' characteristics and audit committee shareholder chairman with earnings management practice of 29 Nigerian financial institutions listed on Nigerian Stock Exchange between 2011 and 2015.

## Literature Review and Hypothesis Development

The board of directors is broadly regarded as an essential player for corporate governance, especially monitoring of firms top management (Faleye, Hoitash, & Hoitash, 2011; Hooghiemstra, Hermes, Oxelheim, & Randøy, 2019; Marra, Mazzola, & Prencipe, 2011; Peasnell, Pope, & Young, 2005; Smit, 2015). Thus, a board with high proportion or number of independent directors can effectively reduce agency cost due to their managerial know-how and reputation (Ghosh, Marra, & Moon, 2010; Hooghiemstra et al., 2019; Larcker & Tayan, 2015; Marra et al., 2011; Moradi et al., 2012).

Prior studies argue that EM is reduced considerably due to the board's independence and audit committee effectiveness (Marra et al., 2011). Klein (2002), Marra et al. (2011), Park and Shin (2004), and Uadiale (2012) reported a negative association between the independence of the board and EM. Moreover, Dechow, Sloan, and Sweeney (1996) indicated that the presence of outside directors reduced financial reporting fraud. However, several empirical pieces of evidence provide conflicting results. According to Peasnell et al. (2005), abnormal income increase is less likely to happen due to the number of independent directors present on board, and equally argued that evidence of outside directors' influence on EM through income decrease is very limited. Furthermore, Ebrahim (2007) found a more significant association between the independence of the board and EM using board meetings as a proxy. Additionally, one of the key functions of the board is to monitor management actions and constraints EM (Larcker & Tayan, 2015; Marra et al., 2011; Moradi et al., 2012; Ntim, 2013). With the new regulations in Nigeria, it is expected that independent directors can play an effective monitoring role and curb EM.

Thus, the underpinning theory of this present study on which the hypotheses are developed is agency theory. However, resource dependency theory is used to add to the theoretical views fundamental to agency theory, especially, regarding the composition of the audit committee. Both agency and resource dependency theories emphasize human factor and governance mechanisms, such as the board of directors and audit committee, to function together to accomplish corporate objectives. The agency theory postulation is that all parties involved in the firms' operations act in

self-interests (Eisenhardt, 1989; Jensen & Meckling, 1976). Additionally, agency theory advocate suggests that human-factor need and corporate governance mechanisms be unified to lower agent quest for acting opportunistically against shareholders' interest. However, resource dependency theory focused on the inflow of resources between firms and suppliers of its resource. Resource dependence theory advocates argue that a firm opposes to and is depending on organization's business that has control over the resources which is critical to its daily operations, and to which at a point has little control (Oliver, 1997; Hillman & Dalziel, 2003).

Beyond audit committee's independence, shareholders as owners, activist, and representatives could improve corporate governance and suppress opportunistic tendencies (Ntim, 2013; Ujunwa, 2012). Therefore, shareholders with basic literacy as well as financial expert in the audit committee can add value to the monitoring as the chair of the committee by improving the financial reporting process (Abernathy, Barnes, Stefaniak, & Weisbarth, 2017; Ghafran & Yasmin, 2018; Schmidt & Wilkins, 2013; Sultana & Mitchell Van der Zahn, 2015). Futhermore, Bromilow (2010), Ghafran and Yasmin (2018), Haq (2015), and Okaro and Okafor (2015) argued that the audit committee chair is to determine the potency of the committee. Thus, the primary contact point between the committee, the management, and external-internal auditors is the chairman (PricewaterhouseCoopers, 2003).

Shareholders in the audit committee could also improve its operational activities such as adequate meetings (Garven, 2015; Ojeka, Iyoha, & Obigbemi, 2014; Sharma, Naiker, & Lee, 2009; Umar & Hassan, 2018). Prior research indicated that committed audit committee members can resolve corporate issues and focus on the corporate activities of the firm through sufficient meetings (Smith Report, 2003). However, studies such as by Baxter and Cotter (2009), and Bedard, Chtourou, and Courteau (2004) found no significant relation between meetings and measures of earnings reporting quality. In the same vein, Zhang, Zhou, and Zhou (2007) reported a positive correlation between diligence and quality of financial reporting. Moreover, Moses (2016) found an insignificant association between the audit committee diligence and EM.

The audit committee size is one of the vital features that enhances its effectiveness. Agency theory suggests that group bonding will be increased by a smaller audit committee size (ACSIZE) as posited by Hillman and Dalziel (2003) and Salihi and Jibril (2015). Moreover, a bigger ACSIZE is likely to raise the risk for opportunistic behavior as the number becomes higher such that collective decision-making becomes impossible (Anderson, Mansi, & Reeb, 2004; Mangena & Pike, 2005). Additionally, Sultana, Singh, and Van der Zahn (2015) argued that a bigger ACSIZE can lead to poor active participation from some members, hence, it hinders cohesion and decreases the ability of the audit committee to achieve vital agreement on monitoring and control.

In contrast, advocates of resource dependence theory contend that a larger size enables members with a wider set of qualities such as experience, knowledge, expertise, and political connections to render it effective. Thus, a large audit committee are able to assess the conduct of the external auditor better (Turley & Zaman, 2007). In the same vein, a larger size will enable the committee to absorb a broader set of skills to enable effective mediation efforts to resolve conflicts that affect audit report (DeZoort, Houston, & Hermanson, 2003).

Consequently, researchers believed that audit quality relates to fewer EM and high quality of earnings report and few abnormal accruals. Hence, brand name auditors such as the Big 4, are associated with higher audit quality outcome (Alzoubi, 2016; Khalil & Ozkan, 2016; Lin & Hwang, 2010; Nelson & Devi, 2013; Okolie, 2014a).

Recent studies document a significant negative relationship between external audit and EM (Alzoubi, 2016; Khalil & Ozkan, 2016). In contrast, other studies report a non-significant association between external audit and EM (Piot & Janin, 2007; Sun, Cahan, & Emanuel, 2011). Several studies have identified the relationship between external audit and proxy by audit fees and audit firm size, and found no significant difference between accruals and EM (Nawaiseh, 2016; Lawrence, Minutti-Meza, & Zhang, 2011; Moradi et al., 2012). Early research used variables to control for factors that are deemed to affect EM (Hodgdon, Tondkar, Harless, & Adhikari, 2008; Okolie, 2014b). Hence, firm size, profit, and return on assets variables are used to control for the present study, and the following hypotheses are formulated:

*Hypothesis 1*: The presence of independent directors on the board relate to lower earnings management in Nigerian financial institutions.

*Hypothesis 2*: Shareholders as audit committee chair constrains earnings management in Nigerian financial institutions

## Research Methodology and Data

The paper employed the use of dynamic panel data which is more convenient in addressing not only the issues of endogeneity, but also the problems of omitted variables, error term measurements, and unobserved heterogeneity (Badinger, 2005; Bond, Hoeffler, & Temple, 2001). Further, the lagged dependent variable $y_i, t_{-1}$ as a right-hand variable is correlated with the error term $u_{it}$, such that static panel data techniques yield inconsistent and biased estimators. Thus, to avert this problem, the use of GMM estimators is employed. Additionally, system GMM is chosen for this paper because it lowers finite sample bias and enhances estimates precision when equated to the other GMM estimators such as difference GMM estimators (Baltagi, 2008). The validity of the GMM is affirmed in small samples when the number of individuals sampled is small as in the case of this present study (Soto, 2009).

Therefore, the data for this study were collected from the annual reports and accounts of the financial institutions listed on the Nigerian Stock Exchange for the years 2011 to 2015. The sample firms were derived using three criteria. First, the study identified banks that survived the 2004 banks consolidation programme of the Central Bank of Nigeria and are still active on the Nigerian Stock Exchange as at 31st December 2015, with the availability of the data for the period under review. Second, all insurance firms who were able to recapitalized and are still active on the Stock Exchange until 31st December 2015 with available data were also identified. Others were dropped due to incomplete data for the study periods. Finally, a sample of 29 financial institutions comprising of 15 banks and 14 insurance companies were used for the periods of 2011 to 2015, which led to 145 firm-year observations. The total population and sample are presented in Table 1.

In selecting the appropriate regression model for the study, the Hausman specification test conducted indicates a significant relationship with Chi2 (9) = 8.15 and a p-value of 0.5187, favoring the use of a random effect model. However, the post-estimation test indicates that heteroskedasticity characterizes the static model with the Chi2 (1) of 17.85 and Prob > F values of 0.0000. The study adopted the modified Jones accrual model by Dechow, Sloan, and Sweeney (1995) as depicted in equation (1):

$$TAC_{it} = EBIT_{it} - CFO_{it} \qquad (1)$$

where TAC is the total accruals for particular firms in a specific year and industry which is the same to the earnings before interest and tax (EBIT) minus cash flow from operation (CFO) while *i* for industry and *t* for the year. Since the total accruals came from revenue and operating activities, ordinary least squares (OLS)

**Table 1**
*Description of the Population of the Study*

| Description | Banks | Insurance | Total |
|---|---|---|---|
| Initial sample | 27 | 32 | 59 |
| **Less:** | | | |
| Banks with no consolidation | (5) | | (5) |
| Insurance with no re-capitalization | | (7) | (7) |
| Banks with no adequate data | (7) | | (7) |
| Insurance with no adequate data | | (11) | (11) |
| **Final Sample** | **15** | **14** | **29** |

cross-sectional estimation was conducted for all firm years and industries to generate the fitted values, and total residuals (DA) is computed from the residuals using equation (2):

$$\frac{TAC_{it}}{TA_{it-1}} = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{it-1}}\right) + \alpha_2 \left[\frac{(\Delta REV_{it} - \Delta REC_{it})}{TA_{it-1}}\right] + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}}\right) + \varepsilon_{it} \qquad (2)$$

where $TA_{it-1}$ = Prior total asset; $\Delta REV_{it}$ = Change in revenues/sales; $\Delta REC_{it}$ = the change in accounts receivables; $PPE_{it}$ = Property, plant, and equipment; and $\varepsilon_{it}$ = Error term. Following Dechow et al. (1995), the changes in account receivable are deducted from the change in revenue before estimation. Consequently, industry-specific, as well as the aspect of the year specific, is used for parameter estimation (coefficients $a_0$, $a_1$, $a_2$, and $a_3$), estimation computed from equation (2) while the NDAs are calculated using equation (3)

$$NDAit = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{it-1}}\right) + \alpha_2 \left[\frac{(\Delta REV_{it} - \Delta REC_{it})}{TA_{it-1}}\right] + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}}\right) + \varepsilon_{it} \qquad (3)$$

The DA gotten from the variation arising from equation (3) and the actual accruals is depicted in equation (4):

$$DA_{it} = ACC_{it} - NDA_{it} \qquad (4)$$

where NDA refers to non-discretionary accrual, and DA represents discretionary accrual. The validity testing of DA model measurement is required before the model is being used.

**Model Specification**

The model of this study attempts to investigate the relationship between BINDP, BEXPT, ACSCR, BIG4, ACMET, ACSIZE, and EM. Following Dechow et al. (1995), Abdulmalik & Che-Ahmad (2016), and Peasnell et al. (2005), this study regards firm size, profitability, and return on assets as control variables. To achieve the objective of the study, the following model is proposed.

$$DA_{it} = \beta0 + \beta_1 BINDP_{it} + \beta_2 BEXPT_{it} + \beta_3 ACSCR_{it} + \beta_4 BIG4_{it} + \beta_5 ACMET_{it} +$$
$$\beta_6 ACSIZE_{it} + \beta_7 FSIZE_{it} + \beta_8 PROF_{it} + \beta_8 PROF_{it} + \varepsilon_{it} \qquad (5)$$

where DA represents the absolute values of discretionary accruals, BINDP is the board independence, ACSCR is the audit committee shareholder chairman, BIG4 is the audit firms, ACMET represents audit committee meetings, ACSIZE is audit committee size, FSIZE is the firm size, PROF is profitability, ROA is return on assets, β is coefficients in the regression model, ε is the error term, and i entity (firm).

**Table 2**
*Summary of Variable Measurement*

| Variables | Measurements | Sources |
|---|---|---|
| BINDP | Number of non-executive directors on board | Marra et al. (2009) |
| BEXPT | Number of financial experts on board | Kibiya et al. (2016) |
| ACSCR | One if the chair is shareholder, 0 otherwise | Ahmed et al. (2018) |
| BIG4 | Dummy "1" if Big 4, "0" otherwise | Abdulmalik & Che-Ahmad (2016) |
| ACMET | Number of meetings held | Klein (2002) |
| ACSIZE | Number of members of the committee | Klein (2002) |
| FSIZE | Natural log of total assets | Peasenell et al. (2005) |
| PROF | Net profit divided by year-end owner's equity | Mollik & Bepari (2012) |
| ROA | Measure by net income divide by total assets | Abdulmalik & Che-Ahmad (2016) |

## Descriptive Statistic of the Modified Jones Model by Dechow et al. (1995)

Table 3 shows that the model is fit and is statistically significant at 1% level of significance, while the explanatory power of R-square is 68%. The explanatory power of the $R^2$ of 68% indicates sufficient evidence on the robustness of Dechow et al. (1995) model to capture financial institutions' DA listed on the Nigerian Stock Exchange market.

The result indicates that property, plant, and equipment negatively relate with total accruals because it serves as determinants to expenses arising due to depreciation. Similarly, the result shows that the coefficient of PPE has a negative association with DA of the model, while the coefficient of change in revenue is positive. It should be noted, however, that the positivity or negativity of the coefficient of change in revenue is because of the increase or decrease in total accruals (Al-Rassas & Kamardin, 2016).

**Table 3**
*Multiple Regression Results of Discretionary Accruals Measurement*

| Variables | Coefficient | t-statistics |
|---|---|---|
| _cons | -0.006 | -0.06 |
| $1/TA_{it-1}$ | -4105.000*** | -2.28 |
| $(\Delta REV-\Delta REC)/TA_{it-1}$ | 0.318*** | 7.76 |
| $PPE/TA_{it-1}$ | -0.118 | -0.85 |
| F-Value | 98.98 | |
| Prob>F | 0.000 | |
| $R^2$ | 0.68 | |
| N | 145 | |

Note: *, **, *** are significant levels at 10, 5 and 1%, respectively

## Descriptive Statistics of Continuous Variables

Table 4 presents the descriptive statistics of the study variables. The table indicates that ABDA had a mean value of 0.241 with a minimum and maximum value of 0.006 and 0.973, respectively. The mean of board independence was eight while the minimum and maximum values are two and 12 respectively. The result shows that mean of board members with financial expertise was two while the minimum and maximum stood at one and seven members, respectively. Moreover, the mean for the audit committee meeting was five while the minimum was two and the maximum was seven. The minimum and maximum values of the audit committee size were three and eight, respectively. The result is consistent with the theoretical perspective of resources dependency theory which primarily focuses on large size, resources exchange, and flow between firms and its supplier of the resource (Sultana & Mitchell Van der Zahn, 2015). The advocates argued that a firm depends upon, and responds to, organizations that control resources vital to firm operation in the firm's environment (Hillman & Dalziel, 2003). The minimum and maximum of firm size showed N6.8 billion and N9.5 billion while the profitability indicates 41% mean and -6% loss as the minimum while the maximum was 97% gain. In the same vein, the return on assets mean was 40% while the minimum and maximum were 1% and 93% respectively.

Table 5 shows that 42.76% of Nigerian financial institutions' audit committee are chaired by shareholders. The result is a sign of good performance by shareholders for the sector which is highly regulated

**Table 4**
*Descriptive Statistics of Continuous Variables*

| Variables | Min | Max | Mean | Sd | Skewness | Kurtosis |
|---|---|---|---|---|---|---|
| DA | 0.006 | 0.973 | 0.241 | 0.244 | 1.063 | 3.137 |
| BINDP | 4 | 12 | 8 | 1.957 | 0.277 | 2.294 |
| BEXPT | 1 | 7 | 2 | 1.142 | 1.437 | 6.068 |
| ACMET | 2 | 7 | 5 | 1.184 | -0.641 | 2.313 |
| ACSIZ | 3 | 8 | 6 | 0.856 | -1.485 | 5.421 |
| FSIZE | 6.880 | 9.559 | 8.278 | 0.974 | -0.220 | 1.371 |
| PROF | -0.062 | 0.976 | 0.410 | 0.255 | 0.474 | 3.058 |
| ROA | 0.013 | 0.931 | 0.406 | 0.284 | 0.529 | 2.096 |

**Notes:** ABDA: Absolute value of discretionary accruals, BINDP: Board independence, BEXPT: Board expertise, ACMET: Audit committee meetings, ACSIZ: Audit committee Size, FSIZE: Firm size, PROF: Profitability, and ROA: Return on assets

**Table 5**
*Descriptive Statistics of Dichotomous Variables*

| Variable Name | Observations | Frequency | | Percent | |
|---|---|---|---|---|---|
| | | 1 | 0 | 1 | 0 |
| ACSCR | 145 | 62 | 83 | 42.76 | 57.24 |
| BIG4 | 145 | 98 | 47 | 67.59 | 32.41 |

ACSCR: Audit committee shareholder chair, BIG 4: Brand name auditors

(Elyasiani et al., 2017). Additionally, the Big 4 audit firms have 67.59% market share among the financial institutions.

Regarding the normality assumption, skewness and kurtosis were used, and the higher threshold of ±3 was utilized as recommended by Hair, Black, Babin, and Anderson (2014), while a threshold of ±10 was used for kurtosis as argued by Kline (2015), thus, the result indicates the normality of the data distribution.

Table 6 depicts the correlation matrix for the study variables. The correlation between ABDA and BINDP was negative with the value of -0.09 and was insignificant. In the same vein, ACSCR was also negatively correlated with ABDA with a coefficient value of -0.20 and was statistically significant at 5%. It means that an audit committee chaired by a shareholder relates to lower ABDA. Furthermore, BIG4 correlates positively with ABDA, and the coefficient value was 0.42 and statistically significant at 1%. This explains that financial institutions audited by Big4 are expected to produce high quality and timely financial report (Khalil & Ozkan, 2016). ACMET was found to negatively correlate with ABDA, positively with BINDP, and negatively with BEXPT and were statistically significant at 1%, and 5% respectively. Furthermore, the results also show that ACSIZE was negative and insignificantly correlate with ABDA. Correlations amongst the control variables were either negative or positive, and statistically significant at either at 1% or 5% which did not significantly differ from expectations. Consequently, the correlation matrix shows no problem of multicollinearity as the values of the coefficients are below the threshold of 0.80 as suggested by Field (2009), while Coakes and Ong (2011) and Hair et al. (2014) suggested a threshold of 0.70 respectively. In the same manner, the mean VIF of 1.42 supported the claim that no high correlation among the variables is envisaged in this study. Overall, multicollinearity is not a serious issue in a panel data study (Baltagi, 2008).

The results of the static panel using random effect indicate only FSIZE was statistically significant at 1% at both random and the robust model while ACSCR became significant when the model is robust and has a negative relationship. The result further justifies the use of GMM which is more robust and efficient. It can also take care of heteroskedasticity and autocorrelation (Semykina & Wooldridge, 2010)

**Table 6**
*Correlation Matrix*

|  | DAC | BINDP | BEXPT | ACSCR | BIG4 | ACMET | ACSIZ | PROF | ROA | FSIZE |
|---|---|---|---|---|---|---|---|---|---|---|
| DAC | 1.00 | | | | | | | | | |
| BINDP | -0.09 | 1.00 | | | | | | | | |
| BEXPT | 0.09 | ***-0.41 | 1.00 | | | | | | | |
| ACSCR | **0.20 | -0.06 | -0.11 | 1.00 | | | | | | |
| BIG4 | ***0.42 | 0.02 | -0.04 | 0.03 | 1.00 | | | | | |
| ACMET | -0.15 | **-0.35 | ***-0.30 | -0.06 | -0.13 | 1.00 | | | | |
| ACSIZ | -0.08 | -0.07 | -0.09 | 0.11 | 0.03 | 0.00 | 1.00 | | | |
| PROF | ***0.33 | 0.03 | 0.00 | **0.21 | ***0.29 | 0.01 | 0.07 | 1.00 | | |
| ROA | -0.02 | 0.07 | 0.00 | **0.25 | -0.13 | 0.14 | 0.05 | ***0.29 | 1.00 | |
| FSIZE | ***-0.62 | -0.04 | -0.08 | **-0.17 | ***-0.64 | 0.13 | 0.05 | ***-0.46 | -0.02 | 1.00 |

*Note: * p < .05, ** p < .01, and *** p <. 001*

**Table 7**
*Random Effect Regression Results*

| VARIABLES | RANDOM EFFECT | RANDOM ROBUST |
|-----------|:-------------:|:-------------:|
| BINDP | -0.0104 | -0.0104 |
| | (-0.00904) | (-0.00904) |
| BEXPT | 0.00556 | 0.00556 |
| | (-0.0164) | (-0.0164) |
| ACSCR | 0.045 | -0.0452** |
| | (-0.0373) | (-0.0225) |
| BIG4 | 0.0606 | 0.0606 |
| | (-0.0604) | (-0.0604) |
| ACMET | -0.0108 | -0.0108 |
| | (-0.0169) | (-0.0169) |
| ACSIZE | -0.0204 | -0.0204 |
| | (-0.0197) | (-0.0197) |
| FSIZE | -0.0988*** | -0.0988*** |
| | (-0.0288) | (-0.0288) |
| PROF | 0.0913 | 0.0913 |
| | (-0.0774) | (-0.0774) |
| ROA | 0.169 | 0.169 |
| | (-0.481) | (-0.481) |
| Constant | 1.111*** | 1.111*** |
| | (-0.268) | (-0.268) |
| R2 | 0.42 | 0.42 |
| Wald Chi2(9) | 42.69 | 86.78 |
| Prob > Chi2 | 0.0000 | 0.0000 |
| Observations | 145 | 145 |

*Note: * p < .05, ** p < .01, and *** p <. 001, Standard errors in parentheses*

Table 8 presents the result of the dynamic panel regression using GMM. Table 8 shows both one step and two step results. However, the study will only report the two-step dynamic result because it is more efficient and more robust. The regression equation considered all variables as potentially endogenous regressors. The results show that the null hypothesis is not rejected by the Sargan test of over-identifying restrictions, indicating that the study's set of instrumental variables are correctly specified and valid. In the same vein, the values of the Arellano Bond test statistics for the second order autocorrelation shows that the model is correctly specified. Thus, the regression result shows that

board independence was negative and statistically significant at 1%, indicating that the presence of a high number of independent directors decreases the magnitude of earnings management, which is consistent with prior literature (Francis & Wang, 2008; Maijoor & Vanstraelen, 2006). The results corroborate our first hypothesis that the presence of independent directors on the board is more effective in curbing earnings management (Klein, 2002; Marra et al., 2011). Board expertise is negative and significant at 5% level of significance which is consistent with (Peasnell et al., 2005).

**Table 8**
*Dynamic Panel Regression Result*

| Variables | One-step system GMM | Two-step system GMM | VIF |
|---|---|---|---|
| L.DAC | -0.647*** | 0.277* | |
| | (-0.105) | (-0.159) | |
| BINDP | -0.0129 | -0.0885*** | 1.35 |
| | (-0.0129) | (-0.0226) | |
| BEXPT | 0.000781 | -0.0983** | 1.36 |
| | (-0.0191) | (-0.0436) | |
| ACSCR | 0.0526 | -0.230*** | 1.18 |
| | (-0.0379) | (-0.0465) | |
| BIG4 | 0.218** | -0.296*** | 1.84 |
| | (-0.0998) | (-0.088) | |
| ACMET | -0.0324 | -0.200*** | 1.24 |
| | (-0.0424) | (-0.0556) | |
| ACSIZE | 0.13 | 1.682*** | 1.05 |
| | (-0.183) | (-0.521) | |
| FSIZE | -0.0211 | -0.206*** | 2.12 |
| | (-0.0416) | (-0.0325) | |
| PROF | 0.128 | -0.0923 | 1.44 |
| | (-0.115) | (-0.137) | |
| ROA | 1.358* | 1.103** | 1.24 |
| | (-0.696) | (-0.448) | |
| Constant | 0.838*** | 1.803*** | |
| | (-0.317) | (-0.533) | |
| Observations | | 116 | |
| AR2 | | 0.467 | |
| Hansen J | | 0.582 | |
| Mean VIF | | | 1.42 |

*Note: \* p < .05, \*\* p < .01, and \*\*\* p <. 001, Standard errors in parentheses*

Audit committee size is positive and significantly associated with DA at 5% (0.002). It means that larger size is not effective in constraining the magnitude of DA. The result also contradicts resource dependence theory which suggests that larger audit committees would effectively monitor the financial reporting process and suppress EM. However, audit committee meetings is found to have a negative association with EM at 1% (0.000). The result affirmed our prediction in which we proposed that the frequency of meeting can lead to a decrease in the level of EM. The result is consistent with both agency and resource dependence theories. The sensitive nature of the financial institutions requires strict regulatory discipline by instituting effective monitoring to check the levels of EM (Elyasiani et al., 2017).

The result further shows that audit committee shareholder chairman is negative and significantly associated with EM at 1% (0.000). The result indicates that shareholder as the chairman of the audit committee can improve in decreasing EM. Moreover, 42.76% of financial institutions' audit committees are chaired by shareholders. It further means that an audit committee headed by a shareholder may likely provide a greater level of determination in the financial reporting process (Mangena & Pike, 2005). Thus, an audit committee chaired by shareholders can reduce the magnitude of EM in their respective firms. Table 8 shows that the Big 4 audit firms dominate the audit market share by 67.59% in Nigerian financial institutions with 1% (0.000) significance level. The result affirmed our expectation that the Big 4 could constrain EM. The findings also affirmed the conclusion reached by (Alzoubi, 2016; Khalil & Ozkan, 2016) that the Big 4 audit firms can constraint earnings management.

As for firm size, the result is negative and significant. The result is consistent with prior studies such as by Abdulmalik & Che-Ahmad (2016) and Jensen (1986) that larger firms tended to choose stricter government regulations and consequently, reduce opportunistic managers' behaviors. PROF is negative but insignificant; however, ROA is positive and significant which is consistent with (Abdulmalik & Che-Ahmad, 2016).

### Robustness Check

To further confirm the validity of our results, we repeat regression of discretionary accruals using extended modified Jones cash flow model by Kasznik (1999) and two-stage least square (2SLS) to check whether the result of Dechow et al. (1995) model is valid, while we use 2SLS to confirm the validity of the instrumented variables in case of endogeneity. As with the case of Dechow et al. (1995), we use absolute values to run Kasznik model. The result is presented in Table 9.

The result shows that the Kasznik (1999) model is also fit and significant at 1% level with the Wald chi2 (10) = 2268.73 while the Prob > chi2 is significant at 1%. The Sargan test of over-identifying restrictions shows that the instrumental variables are correctly specified and valid. In the same vein, the values of the Arellano Bond test statistics for the second order autocorrelation indicates that the model is fit, free from second order autocorrelation. The results further suggest that both models are similar to the main result except for audit committee shareholder chairman which is negative and insignificantly associated with discretionary accruals. Thus, both results are robust and could effectively detect earnings management practice in Nigeria. The MJM model by Dechow et al. (1995) is stronger in detecting EM with $R^2$ of 68% while the Kasznik model has 20% power in identifying EM if compared.

Board independence and audit committee chair as variables of interest were instrumented using two-stage least squares (Krishnan, Wen, & Zhao, 2011). The results of which are presented in Table 10.

The results of models for the instrumental variables are significant at 5% and 1% respectively, indicating that the models are fit. Furthermore, both Sargan test for over-identifying restrictions and Basman test suggest that the models are correctly specified. The results confirm our earlier findings; especially, after controlling for potential endogeneity between board independence variables and audit committee shareholder chairman on earnings management. The regressions results show that the coefficient estimates for both instruments are negative and significant at the 10% and 1% level respectively.

### Conclusion

The ingredients that pollute earnings management practice remains a critical issue for regulators, investors, and researchers on the causes of earnings management. Moreover, findings from previous

**Table 9**
*Dynamic Panel Regression Results Using KASZNIK Cash Flow Model*

| Variables | Coefficient | Std. Err. | z-statistics | P>Value |
|---|---|---|---|---|
| ABSKASZNIK | | | | |
| L1. | 0.2666*** | 0.0266 | 10.01 | 0.000 |
| | | | | |
| BINDP | -0.0209*** | 0.0063 | -3.31 | 0.001 |
| BEXPT | -0.0733** | 0.0348 | -2.10 | 0.035 |
| ACSCR | -0.0867 | 0.0684 | -1.27 | 0.205 |
| BIG4 | -0.2760*** | 0.0558 | -4.94 | 0.000 |
| ACMEET | -0.0865** | 0.0339 | -2.55 | 0.011 |
| AUCSIZ | 0.9138** | 0.4159 | 2.20 | 0.028 |
| FSIZE | -0.1008*** | 0.0169 | -5.96 | 0.000 |
| PROF | 0.0245*** | 0.0046 | 5.28 | 0.000 |
| ROA | 0.0309*** | 0.0053 | 5.79 | 0.000 |
| _cons | 0.8389*** | 0.2848 | 2.95 | 0.003 |
| Wald Chi2(10) | 2268.73 | | | |
| Prob> Chi2 | 0.000 | | | |
| $R^2$ | 0.20 | | | |
| AR2 | 0.579 | | | |
| Sargan | 0.999 | | | |

*Note: * $p < .05$, ** $p < .01$, and *** $p < .001$*


**Table 10**
*Two Stage Least Regression Results*

| Instrumental Variables | Model 1 | Model 2 |
|---|---|---|
| BINDP | -0.0863* | -0.000184 |
| | **(-0.0449)** | (-0.0125) |
| ACSCR | -0.0175 | **-0.370*** |
| | (-0.0457) | **(-0.142)** |
| Constant | 2.036*** | 1.353*** |
| | (-0.386) | (-0.265) |
| $R^2$ | 0.2971 | 0.2218 |
| Adjusted $R^2$ | 0.2447 | 0.1638 |
| Partial $R^2$ | 0.0614 | 0.0915 |
| Sargan Test | 0.160 | 0.7484 |
| Basman Test | 0.1759 | 0.7642 |
| Prob>F | 0.0186 | 0.0028 |
| Observations | 145 | 145 |

*Note: * $p < .05$, ** $p < .01$, and *** $p < .001$, Standard errors in parentheses*

research have continued to be inconsistent due to unobserved heterogeneity. Thus, the present study extended research by employing the GMM technique that reduces these problems. The present study represents the first empirical analysis that examines shareholders performance as audit committee members and, in particular, chairing the audit committee. Regulators and reform advocates should continue to promote the importance of the board independence by empowering it through the independent directors on board as their presence can suppress earnings smoothing. Furthermore, regulators should also consider a regular review of the Code with the aim of injecting more corrective measures due to uncertainty in today's business world.

Consequently, the new Code is a sign of a bright future for the stakeholders in the financial sub-sector of the Nigerian economy given the roles played by financial institutions in the market-driven economy such as Nigeria. The study has several limitations such as few samples, focusing only on board of directors' independence and audit committee. Other board characteristics variables were not considered. This study considered only the financial sub-sector and not considering the adoption of International Financial Reporting Standards. Future research should consider other explanatory variables such as audit tenure and the status of the shareholders. Future research should also extend to the non-financial sector to see the effect of the revised 2011 CG Codes with an adequate sample.

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