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IMPACT OF BOARD ATTRIBUTES ON REAL EARNINGS MANAGEMENT OF LISTED CONSUMER GOODS COMPANIES IN NIGERIA

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ABSTRACT

This study examines the impact of board attributes on real earnings management of listed consumer goods companies in Nigeria. Secondary data were sourced from the annual reports of 16 listed consumer goods companies on the Nigerian Stock Exchange for the period 2011 to 2020. Ordinary least square regression was used. The study measured board attribute with board size, board independence and board financial expertise, while the dependent variable real earnings management with Srivstava (2019) Cohort Adjusted Measure, whereas firm size, firm growth and firm age were used as control variable. The study documents that board size and board financial expertise has significant negative impact on real earnings management of the listed consumer goods companies in Nigeria. Furthermore, board independence has significant positive impact on real earnings management of listed consumer goods companies in Nigeria. In line with the findings, the study recommended that regulatory bodies like FRCN, SEC, and NSE should ensure that listed consumer goods companies in Nigeria increase the size of the board and directors who are expert in finance as it will decrease the level of real earnings management and non-executive directors number shall be reduced as it increases the level of real earnings management.

Keyword: *Board Attributes, Real Earnings Management, Agency Theory*

1. INTRODUCTION

The global corporate scandals that cause distress to companies posed serious questions about the reliability of financial statements relating to their ability to reflect the true

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economic situation of companies. One of the reasons put forward for these scandals is that there was an inherent weakness in governance mechanisms through earnings management. Where, earnings management entails the use of selective judgment in the choice of accounting policies by management and in structuring transactions to alter the financial report to either mislead users or to influence the contractual outcome that depends on the information being reported to the shareholders (Ghazali, Shafieb, & Mohd, 2015). The flexibility of accounting principles also provides managers with considerable ability to adjust accounting earnings (Goretti, 2009).

The separation of ownership and control inherent in the modern corporate organization causes the agency problem between shareholders (the principals) and management (the agent), therefore, no individual shareholder has enough incentives and resources to ensure that management is acting for the shareholders' interest (Jahnke, 2018). To control this agency problem, Nguyen, Doan, and Nguyen, (2020) states that corporate governance is necessary, where, the board of directors as one of the corporate governance components is often considered the primary internal control mechanism to monitor companies including consumer goods companies top management and protect the shareholder's interest.

However, companies manage earnings by reducing discretionary expenses such as reduction of selling, general, and administrative (SG&A) and Research and Development, Advertising, and Maintenance expenditure, because these are expended in the period they are incurred, a reduction in their spending directly flows through to increase income. Thus, another potential characteristic of firms doing real earnings manipulation is lower discretionary expenses and managers can affect current period earnings through abnormal production, using overproduction, for instance, a firm can produce seemingly higher current period earnings, this action will likely and eventually generate lower future period earnings and lower cash flows from the operation. Since production and holding costs on the overproduced items will lead to higher current production costs that are not recovered through the current period sales (Gunny, 2010).

Furthermore, Zubeltzu, Ortas and Álvarez (2019) assert that individuals responsible for governing and managing a firm efficiently and effectively are the board of directors, where a company headed by an effective board is responsible for providing entrepreneurial and strategic leadership for a company to be successful. The board is a link between the shareholders and the company, where they oversee and control all the management activities in the best interest of the shareholders and other stakeholders while sustaining the welfare of the company (Code of Corporate Governance, 2011). An idle board is surrounded with some attributes to be able to execute its responsibility's, these attributes include but are not limited to the size of the board, board composition, board meeting, and board financial expertise.

On the other hand, previous studies focused on the accrual aspect of real earnings management, Abiodun (2020); Fawzi (2020); Abdulwahid and Faozi (2020); Frode, Tolnes, Sondergaard and Anne (2020); Hosam, Eko, Roekhudin, and Wuryan, (2019) Chinedu and Augustine, (2018); Ishaq, Ayoib and Mazrah, (2019); Ben, Sunday and Abisola, (2019); Onwuchekwa and Madumere (2019). However, the current study will use real aspect of earnings management as companies manipulate earnings not only by accruals but also by taking or postponing production or operating actions that adjust the earnings towards the desired target.

On the other hand, exploration of literature on board financial expertise as proxy for board attributes is limited in the developing economy, where, board financial expertise can affect the effectiveness of the corporate board in reducing real earnings management. Independent board members may have intentions to curb accrual-based or real earnings management behaviors for shareholders, but they may not be able to do so without a certain level of financial knowledge. The work of Ishaq, et al (2019) only used one board attribute variable (board independence) while Moustafa and Ahmed (2013) Koevoets (2017) Yayan and Dwi, (2019) and Ben, Sunday and Abisola, (2019), Hyun and Heung (2017), also used only one independent variable (board size).

In view of the foregoing, the need for the study arises as previous studies concentrate on accrual type of earnings management, and the few studies that study real aspect of earnings management measure the variable with Roychoywdhury, (2006) model and the measurement ignores competitive strategy of the firm in an industry, also previous studies ignore board financial expertise as measure of board attributes, in the same vein, previous studies concentrate on other sectors of the economy without putting emphasis on the consumer goods companies. Finally, the need of the study arises with the Enron Corporation scandals in 2001 and Tyco and Cadbury failure.

The main objective of this study is to examine the impact of board attributes on real earnings management of listed consumer goods companies in Nigeria. The specific objectives are to determine the impact of board size, board independence and board financial expertise on real earnings management of listed consumer goods companies in Nigeria.

In order to achieve the above objectives, this paper is divided into five different sections. Section one is the introduction, section two is on theories underlying board attributes and how they relate with earnings management and literature review,

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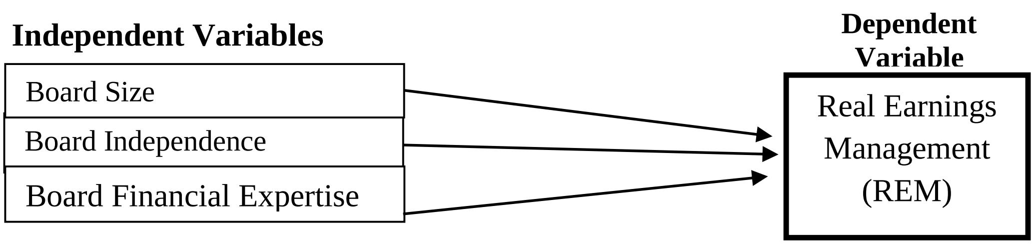
section three covers research methodology, section four focuses on data presentation, analysis and discussion of findings relating to this study, and section five is on conclusion and recommendations emerging from the study.

2. LITERATURE REVIEW

The conceptual framework of the study is presented as follow



Source: Researcher Compilation 2021

This study is based on the agency theory, and in conjunction with opportunistic theory and efficiency contracting theory, this because the control and management of the corporate organization are the relationships that exist between shareholders, the board of directors, and the management of the corporation in determining and reducing the earnings management of the organization (agency theory). It also includes the relationship among various stakeholders for which the corporation is governed (Kim & Rasiah, 2010). Also, the association managers have with the company will guide the board members to exercise accounting discretion and detect real earnings management in an efficient (efficiency contracting theory).

El-Maude, Bawa, and Shamaki (2018) have described board size as the total number of directors on the board comprising the CEO and Chairman and includes outside directors, executive directors, and non-executive directors. Hosam, et al. (2019) sees board size as the total number of directors on the board of each sample firm, which is inclusive of the CEO and Chairman assigned for each accounting year. Tulay and Ozan (2016) sees board size as the total number of directors on the board comprising of the inside and outside director.

Prior studies have documented conflicting results regarding the effect of board size and earnings management. Kankanamage (2015) that board size, board composition, board financial expertise, and board meetings have a significant relationship with the earnings management of the firms. Thus effective board of a firm is contributing to enhancing the financial reporting quality and transparency. Also, Dalila, Mohd, and

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Kamaluddin (2015) results provide significant support on the association between board composition, board size, cross directorship, and senior government officers towards earnings management. Similarly, Ibrahim and Abubakar (2019) concluded that board attributes have a positive and insignificant impact on the financial reporting quality of DMBs in Nigeria.

Board independence is the percentage of independent directors to total directors on the board (Vihi, et al. 2019). Tulay and Ozan (2016) described board independence as the composition of independent inside and outside directors with executive and non-executive power. Insider director is defined as the proportion of directors with executive power over the total directors of the board or ratio of directors with executive power on the board (Chen and Zhou, 2005). Outside directors are independent directors of the board with no executive power/portfolio in running firms' affairs as was observed by (Visvanathan, 2008; and Peasenell, Pope, and Young, 2000). Shehu and Garba (2014) found that outside directors, gray directors, and women directors have a positive association with real activity manipulation, which entails that managers' opportunistic manipulative accounting can be reduced or deter by them while the inside directors could not prevent managers from creative accounting. Similarly, Koevoets (2017) found a negative relation between board independence and earnings quality and a positive relation between directors' tenure and earnings quality. Also, Onwuchekwa & Madumere (2019) found that board independence and audit committee independence have negative relationship, while managerial shareholdings and board political connections have positive relationship with earnings management practices among Nigerian firms.

Board financial expertise can be seen as the number of directors with accounting and finance qualifications (Abubakar, et al. 2017). The effective discharge of the responsibilities of the board and its committees is assured by an appropriate balance of skills and diversity (including experience and gender) without compromising competence, independence, and integrity (Code of Corporate Governance, 2018). Expertise, also known as education, is one of the vital ingredients in decision making which could lead to performance and reduction in earnings management in any organization (Welford, 2007).

Kankanamage (2015) found that board size, board composition, board financial expertise, and board meetings have a significant relationship with the earnings management of the firms. Similarly, Abubakar et al. (2017) found that board expertise and board meetings have a significant positive impact on real earnings management. It was also found that female directors have a significant negative effect on real earnings management. On the other hand, Shanmugavel and Roshan (2019) examined

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board characteristics and earnings management in Sri Lanka and study found that board financial expertise, CEO-Chair duality and earnings management has a positive relationship.

3. METHODOLOGY

This study is an explanatory research that links board attributes and real earnings management. The study population consists of all the 21 listed consumer goods companies in the Nigerian Stock Exchange as at 31st December, 2020, and census sampling techniques were adopted, where all the listed consumer goods companies were used. Because of the nature of the model that was used in the study, a filter was employed to eliminate some of the companies that have no complete records of all the data needed for measuring the variables of the study within the period of ten years (2011-2020). Also, some companies that do not satisfy the following criteria were excluded from the sample: a company must be listed before 2011 and a company must not be suspended from trading within the period of the study (2011-2020) and a company must disclose all the data needed. After applying the filter 16 companies were selected as sample size of the study, the period of the study is from 2011 to 2020. Thus, the study has 160 firm-year observations. Secondary source of data was used to extract information from the annual report and accounts of selected firms between the period been studied. Multiple regression (pool ordinary least square) technique was used as a technique of data analysis. The justification for this technique was that it has the ability to test the statistical relationship among variables and allows for the prediction of the expected outcome.

The dependent variable real earnings management was measured using residuals of Cohort-adjusted measure (2019) model of abnormal cash flow calculated by subtracting the revised measure of the control firm from that of the given firm.

While the independents variables board size was measured as the total number of directors on the board, (Lippolis and Grimaldi, 2020), board independence was measured as the proportion of non-executive directors on the board, (Ishaq et al, 2019), and board financial expertise was measured as the proportion of members that are experts in finance on the board, (Hemathilake, et al, 2019).

The control variables of the study consist of firm size measured as the natural log of total assets, (Hemathilake, et al, 2019), firm growth measured as the percentage of change in sale to present sales, (Babatunde and Adeshina, 2017), and firm age as the age of firm, (Salah, 2018; Kajola, Olabisi, Soyemi and Olayiwola, 2019)

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The model is specified on empirical framework using board attributes as independent variables and real earnings management as dependent variable. The dependent variable for the study is real earnings management while the independent variable is board attributes such as board size, board independence, and board financial expertise, while firm size, firm growth and firm age was used as control variables. Having these variables, the regression models that capture the hypotheses of the study are presented below as adapted from Shehu and Garba (2015):

$$REM_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 BI_{it} + \beta_3 BFE_{it} + \beta_4 FS_{it} + \beta_5 FG_{it} + \beta_6 FA_{it} + \varepsilon_{it.}$$

Where:

REM= Real Earnings Management
BS= Board Size
BI= Board Independence
BFE= Board Financial Expertise
FS= Firm Size
FG= Firm Growth
FA= Firm Age
i = firm
t= period
e = error term

4.1 RESULTS AND DISCUSSIONS

This section covers the presentation, analysis and discussion of the results of the study. Results from the descriptive statistics of all the variables are presented, the correlation matrix and regression results are presented and discussed. Finally, the section closes with the implication of finding.

Table 4.1: Descriptive statistics

Variables	Observation	Mean	Std. Dev.	Min	Max
REM	160	0.0189511	0.1232523	-0.3859847	0.3174161
BS	160	9.99375	2.614658	4	15
BI	160	0.7115629	0.1407454	0.3076923	0.9333333
BF	160	0.5364927	0.1889269	0.0769231	1
FS	160	17.7438	1.51701	14.36926	20.10567
FG	160	0.0493962	0.1842911	-1.23038	0.7240091
FA	160	48.75625	20.18242	6	97

Source: Extracted from STATA 14 Output

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Table 2 shows that real earnings management of listed consumer goods companies in Nigeria have a mean of 0.0189511 with standard deviation of 0.1232523, real earnings management also have minimum and maximum values of -0.3859847 and 0.3174161 respectively. The result indicates that the average manipulation of real earnings by managers in Nigerian listed consumer goods companies is 0.0189511 to 0.3174161. The minimum value Discretionary accruals value of -0.3859847 implies that the lowest earnings management by managers is not serious to cause significant distortion in the financial statement. Board size average stood at 9.99375, ranging from 4 to 15. Board Independence averages 0.8911889, lying between 0.5 and 0.9333. The average of board Financial Expertise is 0.5364927, ranging between 0.0769231 to 1. Firm size averages 17.7438, ranging between 14.36926 to 20.10567. The average of firm growth is 0.0493962, lying between -1.23038 and 0.7240091. While the average of firm age is 48.7562, ranging between 6 to 97 years. There is negligible dispersion of all the standard deviation from their mean, implying that the data is not skewed and is fit to produce a reliable result.

Table 4.2: Correlation Matrix

This section presents and discusses a correlation matrix that explains the level of relationship between independent and dependent variables and between independent variables themselves of the study and also between independent, dependent, and control variables.

Variables	**REM**	**BS**	**BI**	**BF**	**FS**	**FG**	**FA**
REM	1.0000						
BS	0.0595	1.0000					
BI	0.0928	-0.0818	1.0000				
BF	-0.1670	-0.3037	0.3530	1.0000			
FS	0.5345	0.2701	0.0596	-0.1170	1.0000		
FG	-0.0770	0.1467	0.0479	0.0801	0.1687	1.0000	
FA	-0.0051	0.3230	-0.3562	-0.2770	-0.0430	-0.1389	1.0000

Source: Extracted from STATA 14 Output

It is observed from table 4.2 that there is negative relationship between Real Earnings Management and Board Financial Expertise, Firm Growth and Firm Age. This is inferred from the correlation coefficient of -0.1670, -0.0770 and -0.0051 respectively. This indicates that there are inverse relationships between Board Financial Expertise, Firm Growth and Firm Age and Real Earnings Management of listed consumer goods companies in Nigeria. Similarly, it shows a positive association between REM and Board Size, Board Independence and Firm Size which is evident by the correlation coefficient of 0.0595, 0.0928 and 0.5345 respectively. It implies that as there is

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increase in expert on the board the level of real earnings management will reduce and as board size and non-executive directors increase the level of detecting real earnings management reduces. The correlation matrix is used to determine the relationship between all pairs of independent variables in the study model.

To check whether there is a correlation between independent variables which will mislead the result of the study a Multicollinearity Test is conducted. To formally substantiate the absence of multicollinearity between the independent variables, colinearity diagnostics of variable inflation factor (VIF) and tolerance values (TV) are observed and all indicated the absence of multicollinearity in the panel data as all the VIF's are consistently less than 10 and tolerance values consistently less than 1.0 but greater than 0.01 (Tobachnick & Fidell, 1996). In addition, the mean VIF of 1.24 as shown in the above table also support the above position as shown in Appendix II.

Table 4.3: Summary of Regression

Variables	**Real Earnings Management**		
	Coefficient	T-Test	P>/t/
Constant	-0.7431451	-6.51	0.000
BS	-0.0072075	-2.01	0.047
BI	0.1174732	1.80	0.074
BF	-0.1165621	-2.38	0.018
FS	0.0447317	7.83	0.000
FG	-0.0034371	-0.07	0.941
FA	-0.0004006	0.85	0.396
Prob>F	0.0000		
F	12.37		
R^2	0.3267		
Adj R^2	0.3003		

Source: Extracted from STATA 14 Output

Table 4.3 shows that there is a negative significant relationship between board size and real earnings management of listed consumer goods companies in Nigeria. This is observed from the coefficient beta of -0.0072075 with p-value of 0.047 which is significant at 5% level of significance. This indicates that the size of board members has negative significant impacts on real earnings management of listed consumer goods companies in Nigeria. The implication of this result is that, larger board guarantee qualitative financial information of listed consumer goods companies in Nigeria and thus reduces the level of real earnings management. Too many members on the board with the requisite industry experience and a passion for their work may prevent managers from engaging in opportunistic accounting which reduces real earnings management. This finding is in line with those of Musa *et al* (2013), Uwalomwa, *et al* (2014), Imoleayo, *et al* (2016), Hemathilake et al. (2019); Emeka, *et al* (2019), but contradicts the findings of Chinedu & Augustine (2018), Olaleye & Amafa (2019).

Similarly, the result in respect of board independence and real earnings management proved right as it shows a positive significant relationship with Real Earnings Management with a p-value of 0.074 at 10% level of significance, a coefficient of 0.1174732 which is statistically significant at 10%` level of significance. This implies that the larger the number of non-executive directors on board in the listed consumer goods companies in Nigeria, the more the possibility of managers to engage in real earnings management which will affect the quality of information contained in the financial statement of listed consumer goods companies in Nigeria. The above findings is however, not consistent with that of Chinedu & Augustine (2018); Ishaq, *et al* (2019); Onwuchekwa & Madumere (2019); Olaleye & Amafa (2019); but in line with Shehu (2013); Hemathilake et al. (2019); Hussaini & Gugong (2015), who also established a significant positive association.

Also, Table 4.3 provides evidence that there is negative significant relationship between board financial expertise and real earnings management of listed consumer goods companies in Nigeria. This is deduced from the coefficient of -0.1165621 and p-value of 0.018 which is significant at 5% level of significance. This implies that the financial expertise of board member has effect on manager's engagement in earnings manipulation which will reduce real earnings management in listed consumer goods companies in Nigeria. This is not consistent with Hemathilake *et al.* (2019) and Abubakar *et al.* (2017) who found that the presence of board member with financial expertise is positively associated with the levels of earnings management, but in consistent with the studies who found that board members with financial expertise is not effective in detecting earnings management.

Table 4.3 shows that there is a positive significant relationship between firm size and real earnings management of listed consumer goods companies in Nigeria. This is inferred from the coefficient value of 0.0447317 with p-value of 0.000 which is statistically significant at any level of significant. This implies that firm size serve as a means of reducing real earnings management. This result also implies that firm size may serve as an effective tool for constraining managers for engaging in opportunistic accounting practices. This is contradicting with the finding of Siyanbola, *et al.* (2019) and in consistent with the studies of Egbunike, *et al.* (2015).

The coefficient in respect of firm growth was found to be negatively related to the real earnings management of listed consumer goods companies in Nigeria. The variable, coefficients value of -0.0004006 and t-value of 0.941 which is statistically insignificant at any level depicts this submission. The implication of this result is that growth of a firm is not capable of preventing real earnings management and manipulation of accounting numbers practiced by managers either to benefit privately or to mislead users of financial statement.

In other to investigate the effect of firm age on real earnings management, the regression results as presented in table 4.4 indicates a coefficient of -0.0004006 with a t-value of 0.396 which is statistically insignificance at any level of significance (p-value 0.718). This result indicates that there is a negative association between firm age and the real earnings management. This means that the older the company the less the possibilities of reducing real earnings management and manipulating accounting numbers by the managers which is increasing the quality of financial information conveyed to users in the financial statement. This result support that the age of firms can reduces the chances of managers to manage earning which will increase the quality of financial information of listed consumer goods companies in Nigeria.

4.2 Robustness test

Heteroscedasticity Test is conducted to check whether the variability of error terms is constant or not. The present of heteroscedasticity indicates that the variation of the error term is not constant which would affect the best linear unbiased estimators (BLUE) of the study. The result of the test reveals that there is no presence of heteroscedasticity because the hettest chi2 is 1.70 with a probability of 0.1921 which is not statistically significant at 5%, indicating that the data are homoscedastic. This suggests that the original OLS regression suit the study.

5. CONCLUSION AND RECOMMENDATIONS

This study examines the interaction between three aspects of board attributes and real aspect of earnings management of listed consumer goods companies in Nigeria. Consequently, based on the findings of the study the following conclusions are drawn.

i. There is negative significant relationship between board size and real earnings management of listed consumer goods companies in Nigeria,
ii. The study concludes that, there exist positive significant association between board independence and real earnings management of listed consumer goods in Nigeria.

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iii. The study concluded that, there is a negative significant relationship between board financial expertise and real earnings management of listed consumer goods companies in Nigeria.

In line with the findings and the conclusions of the study, the following recommendations are made: Regulatory bodies like NSE, SEC, and FRCN should ensure that listed consumer goods companies in Nigeria should ensure the following:

i. Increase the number of board members as a negative relationship is found between board size and real earnings management, which will reduce the level of real earnings management in listed consumer goods companies in Nigeria.

ii. Contralily, the non-executive directors on the board should be reduced as positive relationship is found between board independence and real earnings management, which will increase the level of real earnings management in listed consumer goods companies in Nigeria.

iii. On the other hand, board members who are expert in finance should be increase as a negative relationship is found between board financial expertise and real earnings management, which will reduce the level of real earnings management in listed consumer goods companies in Nigeria.

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APPENDEIX

LISTED CONSUMER GOODS COMPANIES IN NIGERIA AS AT 31/12/2020.

S/N	Company Name	Listing Date
1	Cadbury Nigeria Plc	1976
2	Dangote Sugar Refinery Plc	2007
3	Dangote Flour Mill Plc	2008
4	Champion Brew Plc	1983
5	DN Tyre & Rubber Plc	Invalid date
6	Flour Mills Plc	1979
7	Golden Guinea Brew Plc	Invalid date
8	Guinness Nig. Plc	1979
9	Honey Well Flour Mill Plc	2009
10	International Breweries Plc	1995
11	Mcnichols Plc	2009
12	Multi-Trex Integrated Foods Plc	2010
13	Northern Nig. Flour Mill Plc	1978
14	Nascon Allied Industries Plc	1992
15	Nestle Nigeria Plc	1973
16	Nigerian Brew Plc	1973
17	Nigerian Enamelware	1976
18	PZ Cussons Nig. Plc	1974
19	Unilever Nig. Plc	1973
20	Union Dicon Salt Plc	1993
21	Vita Foam Nig. Plc	1978