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CORPORATE GOVERNANCE AND REPORTED EARNING QUALITY IN DEPOSIT MONEY BANKS IN NIGERIA

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ABSTRACT: *This study examined the effect of Corporate Governance on Reported Earnings Quality in Nigerian deposit money banks. Cross sectional data were obtained from Ten (10) listed deposit money banks in Nigerian Stock Exchange for over a period of ten years (2008-2017). The data were analyzed using both descriptive and inferential statistics. Earnings predictability was adopted as a proxy for reported earnings quality, while board size, board independence, foreign directorship and firm size were used as proxies for corporate governance. The study found board size having a positive and insignificant relationship with earnings quality; a negative and insignificant relationship between board independence and earnings quality; a positive and significant relationship between foreign directors on board and earnings quality; and also a negative and insignificant relationship between firm size and earnings quality. It was therefore recommended that deposit money banks should increase both their board size and number of foreign directors on board as these will enhance their reported earnings quality.*

KEYWORDS: board independence, board size, corporate governance, earning quality, foreign directors

INTRODUCTION

Earnings quality has been an issue of concern in the corporate business world, most especially deposit money banks. The truthfulness or fairness of earnings reported in corporate organization has been something not totally reliable due to some unethical practices by entities' management. These practices include: earnings management, income smoothening and financial engineering.
Organizations communicate their affairs to interested parties, majorly through their financial statements. These financial statements contain important information useful to shareholders, creditors, regulatory authorities and other interest groups such as professionals and government. These interested parties have specific and distinctive areas of interest in the financial statement as each party concentrates on its own area of interest with a view to safeguarding the stakes in the entity (Ibrahim, 2017).

Financial reporting is mostly targeted at giving information to direct stakeholders' choices in entities. It is therefore the obligation of directors of the entities to present a financial report as prepared by accountants and confirmed by auditors at every annual general meeting for ratification. As agreed by Majiyebo, Okpanachi, Nyor, Yahaya and Mohammed (2018), this report

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focuses on producing relevant, reliable and accurate information to help users in making the right choice of decision.
Objectivity is synonymous to high earnings quality in accounting process. This is always the watch word in accounting standards setting. Panyam (2013), earnings quality is one of the most essential features of financial reporting systems. Hence high quality financial information enhances capital market productivity as investors are normally interested in such high-quality information as pre-requisite for investing in the entities.

Much as earnings quality is required by every stakeholder, entities embark on earning managements to cover up for their inefficiencies. Then again, earnings management is known to diminish the desired reliability and as such, reduces its significance to decision making (Bugshan, 2005). This has drawn serious attention and concerns amongst financial operators, investors, financial market regulators, and academic researchers, (Uwuigbe, Uwuigbe & Okorie, 2015). The attention to earning managements has been on the increase due to the expanding number of corporate failures all over the globe. Managers opportunistically use discretion over income statement classification within a period to transfer expenses into classes that might be seen as less persistent to link with the analyst forecasts (Mcvay, 2006). Occasionally, these opportunistic discretions are regarded as creative accounting.

Most opportunistic discretions that result in fraudulent earning managements were traced to bad corporate governance, which had become one of the most debated issues all over the globe, (Okoi, Ocheni & Sani (2014). The history of corporate governance in Nigeria followed that of US, consequent upon the high ranking scandals that led to the enactment of Saban-Oxley Act 2002 in the US. In 2001 the Securities and Exchange Commission (SEC) of Nigeria set up a committee that came up with a code of best practices for public companies in Nigeria ("the code" in 2003). This was followed by the Institute of Directors of Nigeria in 2005, when it set up a Centre for Corporate Governance to champion the cause of good corporate governance amongst its members. In 2006 the Central Bank of Nigeria issued post-consolidation corporate governance guidelines for all banks operating in Nigeria;

All codes of corporate governance aim at ensuring that managers and investors of companies carry out their duties within a framework of accountability and transparency. They all ensure that the interests of all stakeholders are recognized and protected as much as possible. Specifically, to the banking industry, effective boards and corporate governance practices are essential ingredients in achieving and maintaining public trust and confidence in the financial system. They are critical to proper functioning as they determine the performance of the banking sector of the economy in any country of the world. Poor corporate governance may lead to ineffective boards, which eventually may contribute to bank failures. Also, poor boards could in turn lead to a run on the bank, unemployment, fraudulent activities and questionable dealings that may impact negatively on the economy (Ogbechie & Koufopoulos, 2010).

Statement of the Problem
Reported high profile accounting scandals involving such entities as Xerox, Enron, WorldCom, Adelphia, Tyco, Parmalat, One-Tel, HIH, and Cadbury Nigeria PLC at the turn of the century, have been a source of serious concerns about corporate governance practices in general and

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attentions have been directed at quality of financial reporting of corporate entities. A good number of businesses has collapsed both nationally and internationally over time as a result of lack of good corporate governance. In the last two decades, the United Kingdom, United States of America, Brazil, Japan, Canada, France, and many Asian countries have recorded business failures occasioned by corporate governance issues. (Bell & Pain, 2010).In Nigeria, several banks (Savannah Bank, Societe Generale Bank of Nigeria, Peak Merchant Bank, Oceanic Bank, Intercontinental Bank, Union Bank, Afribank, Finbank, ETB, Springbank) have failed and investors lost huge amount of money as a result of weak corporate governance structures shown by their long term insolvency and illiquidity. For instance, some of the banks that have failed due to weak oversight of the board, financial mismanagement and established cases of board complicity are Intercontinental bank, Oceanic bank, Fin bank and Bank PHB (Owolabi, 2013). The current financial crisis in the banking sector of Nigerian economy which has been credited to the abuse of corporate governance practices is identified as one of the factors responsible for the failure of many banks in Nigeria. The financial health and performance of banks are important for the economic growth of Nigeria. According to King and Levine (1993), banks play three crucial roles to the development of any nation. Firstly, they have an overwhelming dominant position in the financial systems of developing economies, and are they are considered to be the engines of economic growth. Secondly, they are considered as the most important avenue for sourcing funds by entities. Also, they are the main depository for the economy's savings and provide the means for payment. Therefore, the role played by the banking industry in Nigeria toward the development of the country's economy, cannot be underplayed.

Corporate governance encompasses the controls and procedures that exist to ensure management acts in the best interest of shareholders. However, in the lights of recent financial crisis around the world especially in Nigeria, there is unprecedented attention paid to corporate governance principles and standards by academics, government institutions and corporate bodies.
Securities and Exchange Commission (SEC), code of corporate governance, 2008 was aimed at strengthening the governance structures of all public listed companies. It serves as a minimum standard to guide companies in building best practices of corporate governance structures.

Objective of the study

The main objective of the study was to examine the effect of corporate governance on reported earnings quality of deposit money banks in Nigeria. Specific objectives were to:

(i) determine the effect of board size on reported earnings quality of deposit money banks in Nigeria;

(ii) evaluate the effect of the existence of independent directors on reported earnings quality of deposit money banks in Nigeria;

(iii) assess the effect of the presence of foreign directorship on reported earnings quality of deposit money banks in Nigeria;

(iv) investigate the effect of firm size on reported earnings quality of deposit money banks in Nigeria.

HYPOTHESES

The following hypotheses were tested to achieve the stated objectives

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(i) board size has no significant effect on reported earnings quality of deposit money banks in Nigeria
(ii) the existence of independent directors do not have any significant effect on reported earnings quality of deposit money banks in Nigeria
(iii) the presence of foreign directorship on the board does not have any significant effect on reported earnings quality in deposit money banks in Nigeria
(iv) firm size has no significant effect on reported earnings quality of deposit money banks in Nigeria

LITERATURE REVIEW

Conceptual Review

Earnings Quality

Earnings quality and earnings management are interchangeably used in literatures, however the degree of earnings management normally determine the earnings quality of reported figures in financial reports (Vasiliki, Stergios, Emmanouli & Stephen, 2014). This view has been variously supported by scholars as Ralf & Alfred, (2009); Chan, Jegadeesh & Lakonishok (2006). The degree of quality points to the ability of reported earnings to forecast the entity's future performance (Gregory, 2014; Mary, 2017). Since high earnings quality boosts capital market efficiency, shareholders place much importance on high quality financial accounting information in their decisions to invest or divest their investments in/from entities. Consequently, accounting standards setters attempt to create standards that boost earnings quality having in mind current developments in auditing and corporate governance. Accrual quality using discretionary accrual, earning predictability and income smoothing have been the common proxies used to confirm earning qualities in financial statement. We adopted earning predictability in this study, as we found it to be the most suitable in this instance.

Corporate Governance

Aside the institutional definitions, Corporate Governance has been variously described by authors to include in-house structure designed to direct and control management functions with a view to protecting investors' stakes in entities (O'Donovan, 2003). This definition was also reflected in the view of Asuagwu, (2013) by regarding it as the structure used in reducing agency costs between the interest of principals and agents. However, Wilson (2006) in his own view regarded it as the manner by which entities are directed, controlled, and held to account for their resources. To Oghojafor, George, and Owoyemi (2012) and Plender (2003), it is all about the structures put in place by entities to deal with their stakeholders in fair manners. Narrowing it down to the fair treatment of shareholders, Onuoha (2014) summarized the objective of corporate governance as the structures instituted to ensure value maximization of entities. Different variants of corporate governance mechanisms have been used in previous studies, some of which are: board size, board meeting, board gender, independent directors, executive/non- executive directors, audit committee composition, audit committee meeting, audit committee independent, foreign/home directors, local/foreign auditors. For the purpose of this study, we adopted board size, board independence, foreign directorship and firm size as proxies for corporate governance as we also found to them to be more relevant for our study.

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THEORETICAL REVIEW

Much of the research into corporate governance derives it theoretical base from Agency theory, this study further discussed stakeholder theory, legitimate theory.

Agency Theory

Agency theory was popularized by Jensen and Meckling in 1976, a refined version of 1932 Berle and Means reports (Hsiangtsai, Li-Jen & Cang-Fu, (2015). Agency problem exists due to conflicting interest of the principal (investors) and the agents (managers) (Watts & Zimmerman, 1986). There is the likelihood that managers will carry out activities that might ultimately be to the detriment of the company and stakeholders to satisfy their selfish need (Huang, 2011). To make it easy for the managers to satisfy his selfish desire, he will create information gaps to inform the investors only what they should hear. According to Fields, Lys and Vincent (2001) when managers have greater access to the information compared to the owners, there abounds information asymmetry. This arises as the agent has access to information that is superior to the information accessible to the principal (Jensen & Meckling, 1976). Agency theory focuses on the principal-agent problem that arises in such relationships. It holds that managerial behavior can be opportunistic and fuelled by self-interest (Davis, Schoorman & Donaldson, 1997).

Stakeholders' Theory

Freeman (1998) defined stakeholders as groups and individuals who benefit from, or are harmed by, and whose right are violated or respected by corporate actions. According to Clarkson (1995) we have primary and secondary stakeholders in entities. Primary stakeholders are those who continuously in improve the going concern attributes of the entities. Those in this category are: investors, employees, customers, suppliers, government and community. Secondary stakeholders are those who influence/are influenced or affect/ affected by the entities. These are neither engaged in transactions with the entities nor essential for their survival. According to Freeman, Wicks and Farmer (2004), for organizations to be effective, they must pay attention to all those relationships that can affect or be affected by the achievement of the organization.

The stakeholders' theory was adopted as a refinement of agency theory, as the latter theory only dealt with the problem between the agent and the investors, as the sole principal, but the stakeholders' theory has widened the problem of agency by including multiple principals (Sand, Garba & Mikailu 2011).The stakeholders' theory proposes that companies have a social responsibility that requires them to consider the interest of all parties affected by their actions. The original proponents of the stakeholders' theory suggested a restructuring of the theoretical perspectives that extends beyond the owner manage-employee position and recognizes the numerous interest groups.

Legitimacy Theory

The legitimacy theory is derived from the concept of organizational legitimacy. It is seen from two angles namely: the institutional angle which is a macro theory concerned with how organizational structure gain acceptance and empowerment by the society; and organization level, a micro level, which is concerned with how organization through their own activities and actions establish and defend their legitimacy. (Suchman, 1995). According to Dowling and Pfeffer (1975),

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organizational legitimacy exists when there exists a goal congruence between an entity's value system and the larger social system of which the entity is a part. When a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy. The theory supports that every organization should aim at ensuring the legitimacy of their operations by operating within the bounds and norms of specific societies (Deegen & Unerman, 2011).
The legitimacy theory in essence explains that the society allows organization to continue to operate to the extent that they meet their expectations and that the management will adopt strategies to assure the society that the organization is complying with the society's values and norms for survival and stability.

Theoretical Framework
All theories reviewed are relevant to this study in one aspect or other. However, this study was hinged on the agency theory in line with many previous studies on corporate governance. The agency theory is premised on the principal-agent relationship, which relates with the managers in charge of the firm's earnings quality, on one hand, and the shareholders, represented by the board of directors, on the other hand. As such, the assumptions of this theory as discussed earlier provide a link between the activities of managers and decision of the owners of the business.

Empirical Review
Manukaji (2018) studied Corporate Governance and Income Smoothing in the Nigerian Deposit Money Banks. It was demonstrated that board size is not effective in monitoring income smoothing. However, the study revealed a significant relationship between corporate governance and income smoothing in Nigerian deposit money banks. This positive relationship was supported by the earlier study of Nkanbia-Davies, Gberegbe, Ofurum and Egbe (2016), where there was a positive relationship was reported between corporate governance (board size and independent directors) and accrual quality. However no relationship was established between independent audit committee and accrual quality in that study.

Okoi, Ocheni and Sani (2014) studied the Effects of Corporate Governance on the Performance of Commercial Banks in Nigeria. The study revealed a positive effect of corporate governance on banks' performance and value. This was in agreement with the study of Okoye, Evbuomwan, Achugamonu, & Araghan (2016). The studies saw the need for strong governance standards for banks on the premise that increased governance quality leads to higher levels of investment as well as greater responsiveness of investment to growth opportunities. Board characteristics were used as proxy for corporate governance by Abu, Okpeh, Arumona & Uchenna (2016). The study found foreign directors significantly and positively influencing the performance of deposit money bank in Nigeria, while home directors have negative significant effect. However, both executive directors, independent non-executive directors and women directors did not have any significant effect on banks performance in Nigeria.

Majiyebo, Okpanachi, Nyor, Yahaya and Mohammed (2018) used audit committee independence and audit committee size as proxies for corporate governance. The study found audit committee independence negative but significantly affecting financial reporting quality of listed deposit money banks in Nigeria. However, audit committee size exhibited no significant effect on the financial reporting quality of listed deposit money banks in Nigeria. Adebiyi (2017) study, using

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discretionary accrual as proxy for quality of financial reporting; board size, board independence and board meeting as corporate governance proxies found board size and independence positively related while board meeting was negative. Hence the study established board composition as a key component of the quality of financial reporting, while the meeting did not have any effect on the quality of financial reporting of deposit money bank in Nigeria.

Igodo (2017) also found board meetings having negative effect on earnings management. Also, board gender and institutional ownership also relate negatively with earnings management. Audit committee meeting, on the other hand, exhibited positive effects on earnings management. Firm size, used as the control variable, also affected earnings management positively. The findings support the application of corporate governance principles as motivating factor used to ensure quality earnings management practice in Nigerian food product firms. Olaoye and Adewumi (2018) found the engagement of the service of reputable audit firms having a positive but insignificant effect on the earnings management of the sampled banks while board size exhibited negative and insignificant effect on their earnings management. However, independent directors on the board and leverage have a negative but significant effect on earnings management of Deposit Money Banks in Nigeria.

METHODOLOGY

This study examined the relationship between corporate governance and reported earning quality of deposit money banks in Nigeria. Ten (10) banks were used from the period of 2008-2017, giving a total observation of hundred (n=100). Data were sourced from the annual reports of the banks. Earnings predictability (EP) was used as a proxy for Reported Earnings quality, while Board size (BS), Board independence (BI), Foreign directorship (FD) and Firm size (FS) were used as proxies for Corporate governance. Firm size (FS) was used as the control variable.

The pre-estimation analysis was done in two-folds: the first provides descriptive statistics for all the variables employed in this study as well as correlation analysis to check for multicollinearity between the independent variables; the second shows the associations of the variables using a panel ordinary least square regression.

Model Specification

The following models were stated to guide the test of hypotheses;

$EP= f\,(BS, BI, FD, FS)$……………………………………………………………….(1)

Equation (1) above is specified as an econometric model in equation (2) below:

$EP_t= \beta_0 + \beta_1 BS_t + \beta_2 BI_t + \beta_3 FD_t + \beta_4 FS_t + \mu_t$ …………………………………………….(2)

where:
EP= Earnings Predictability
BS= Board Size
BI= Board Independence
FD= Foreign Directorship
FS= Firm size

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μ= Error term

β_0 is the constant, and β_1.... β_4 coefficients of independent variables of the above model (2) capturing the impact of changes in each independent variable on the dependent variable. Subscript, $_t$, refers to the time period of observations, $_{t=}$ 2008-2017.

Data Analysis

Descriptive Statistics

	EP	BS	BI	FD	FS
Mean	7.597774	13.59000	0.155900	0.081100	12.04812
Median	3.745846	14.00000	0.140000	0.000000	12.10805
Maximum	112.4282	20.00000	0.290000	0.540000	12.74780
Minimum	-22.86442	6.000000	0.060000	0.000000	11.07960
Std. Dev.	17.39659	2.800054	0.049361	0.132367	0.397822
Jarque-Bera	1229.257	1.700547	4.488650	58.07263	4.296701
Probability	0.000000	0.427298	0.105999	0.000000	0.116676
Sum	759.7774	1359.000	15.59000	8.110000	1204.812
Sum Sq. Dev.	29961.49	776.1900	0.241219	1.734579	15.66795
Observations	100	100	100	100	100

Source: Authors Computation (2019)

Interpretation

The table above shows the descriptive statistics of the variables under study. The mean shows the average value of the data set, the maximum and minimum show the highest and lowest values in the data set respectively. The Jacque-Bera shows the normality of the variables and most of the variables were significant at 5% level depicting normality in the data set for this study.

Descriptive Statistics

	EP	BS	BI	FD	FS
EP	1.000000	0.051490	-0.024660	0.181676	0.083101
BS	0.051490	1.000000	-0.249071	-0.001496	0.012280
BI	-0.024660	-0.249071	1.000000	0.087735	0.364920
FD	0.181676	-0.001496	0.087735	1.000000	-0.231513
FS	0.083101	0.012280	0.364920	-0.231513	1.000000

Interpretation

The table above shows the relationship between the variables considered for this study. It is also used to check for multicollinearity between the variables. Based on the benchmark of 80% as recommended by Okere, Isiaka and Ogunlowore (2018), it can be seen that there exists no multicollinearity between the variables under study. The highest correlation in the table is between firm size and board independence with a correlation of 36%.

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Regression analysis

Dependent Variable: EP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BS	0.003528	0.382794	0.009218	0.9927
BI	-1.297958	13.06420	-0.099352	0.9211
FD	71.20100	34.19309	2.082321	0.0403
FS	-2.596993	2.976530	-0.872490	0.3854
C	33.26667	33.04460	1.006720	0.3169

Weighted Statistics

R-squared	0.347525	Mean dependent var	12.71483
Adjusted R-squared	0.248895	S.D. dependent var	18.82482
S.E. of regression	15.40947	Sum squared resid	20420.85
F-statistic	3.523529	Durbin-Watson stat	2.308100
Prob(F-statistic)	0.000203		

The table above captures the relationship between corporate governance and reported earning quality in Deposit Money Banks in Nigeria. The regression shows R-squared of 35% and adjusted R-squared of 25% depicting that 25% of changes in the dependent variable (EP) can be explained by the independent variable. The F-statistics is positive (3.523529) which shows the fitness of the model and is validated by the probability of the f-statistic which is significant at 1%, 5% and 10% levels of significance. The Durbin Watson statistics value of 2.31 shows there is evidence that the parameter estimates are free from autocorrelation. From the analysis, it is revealed that there is a significant relationship between corporate governance (BS, BI, FD, FS) and earnings quality in deposit money banks in Nigeria.

Also, examining the individual coefficients of the independent variables, it can be seen that there exists a positive (0.003528) but insignificant (0.9927) relationship between board size and earnings quality (EP) in deposit money banks in Nigeria. These findings are in line with the works of Adams & Mehran (2002).There exists a negative (-1.297958) and insignificant relationship between board independence and earnings quality (EP) in deposit money banks in Nigeria. These findings are in tandem with the works of Priya & Nimalathasan (2013).

Furthermore, there exists a positive (71.20100) and significant relationship between foreign directors on board and earnings quality (EP) in deposit money banks in Nigeria. These findings are in tandem with the works of Munch-Madsen & Funch (2013). Also, the control variable Firm Size (FS) shows a negative (-2.596993) and insignificant relationship with earnings quality (EP) in deposit money banks in Nigeria. These findings contradicts the works of Ibrahim (2017).
The combined effects (F-stat) of all the independent variables on dependent variable at 3.523529 with p-val. 0.000203 revealed that corporate governance (board size, board independence, foreign directors on board, firm size) had a significant effect on earnings quality in deposit money banks in Nigeria.

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CONCLUSION & RECOMMENDATION

This study examined the effect of corporate governance on reported earnings quality in deposit money banks in Nigeria, using an observation of 100, from 2008-2017. The study concluded that there is a positive and insignificant relationship between board size and earnings predictability, a negative and insignificant relationship between board independence and earnings predictability, a positive and significant relationship between foreign directors on board and earnings predictability, and also a negative and insignificant relationship between firm size and earnings predictability.

Based on the conclusion, the study recommended that deposit money banks should increase their board size and also employ foreign directors on their board so as to enhance their reported earnings quality.

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