The impact of Earnings Management on Financial Performance of Listed Deposit Money Banks in Nigeria

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Abstract
This study examines the impact of earnings management on the financial performance of listed deposit money banks in Nigeria. Data was extracted from the annual report and accounts of 5 sampled banks for the period 2011-2015. Loan loss provision was used as a proxy for earnings management while return on assets (ROA) was used as proxy for banks performance. The study employed linear regression of pooled ordinary lease square for data analysis. Findings from the study revealed that earnings management exist in the Nigerian Money Deposit Banks. However, the study could not establish any statistical significant impact of earnings management on ROA. It is therefore, recommended that even though the relationship between the variables are not significant, proper and adequate measures should be put in place for the evaluation, examination and scrutinization of financial statement of DMBs.

Keywords: *Earnings management, loan loss provision, ROA, pooled OLS.*

Introduction
Financial report is shown by an information management to assess the quality of a firm's performance and demonstrate its responsibility to investors, employees, customers, society and government. Financial report serves to present information to help investors, creditors, and other potential users in a similar decision rationally. The statements are very important because of the demonstration of quality of management performance in a period of time. One importance of financial statements is its use to measure management performance. Therefore, management will try to make a financial report in such a way that the performance of the company looks good in the financial statements. Due to the important role of financial statements in demonstrating the performance of a company, the management will try to mislead investors or the owner of the company to avoid the confidentiality of the actual condition of the financial statement. One way that is often applied to mislead the owner of the company or investors is conducting earnings management, because the manipulation of earnings management is the safest and legal, and does not violate generally accepted accounting principles (Haryudanto & Yuyetta, 2011).

Following these scenarios, earnings management also called creative accounting, aggressive accounting, according to Ignacio (2009) is the manipulation of financial numbers, usually within the letter of the rules of law and standard accounting practices, but deviating from the spirit of those rules and certainly not providing the true and fair view that accounts are supposed to. This (earnings management) is becoming an area of interest to many researchers, after the case of Enron, WorldCom, and other similar accounting scandals in Nigeria particularly in deposit money banks.

In 2013, the House of Representatives Committee on Finance accused commercial banks in the country of sundry sharp practices, including tax evasion, non-remittance of government revenue and outright falsification of their accounts. In a report released on the 25th of August 2013, the committee said it had uncovered a lot of discrepancies in the data submitted to it by the banks including the outright refusal to present documentary evidence of revenue remittances, blank violations of existing laws, self-exemption from existing rules, false declaration and manipulation of financial information (Ijeoma, 2014).

Preliminary findings showed that the published audited accounts of some banks were at variance with the figures the banks submitted to the committee during investigation. It was then revealed that many banks blatantly engage in the creative accounting technique of inflating their operating costs to reduce exposure to taxes. In other words, over the years, the Nigerian government lost billions of naira in fraudulent and under hand dealings corruptly designed by some banks to evade taxes. The effect of this large scale corruption on the nation's economy is unquantifiable. Furthermore, Ahmad (2011) asserted that some banks also created exemption rules for themselves in total disregard for the provisions of extant tax laws, particular violations of the stamp duty, withholding tax and value added tax (VAT) laws. There are also many cases of late remittances or outright failure to remit money collected on behalf of government.

Previous studies (Anichebe; 2009 and Shehu and Abubakar, 2012) on earnings management and performance focused on other measures of earnings management like operational risk and total accruals. Other studies that used loan loss provision have a different time period or were conducted in a different sector (Abubakar, Abdu & Abdulmaroop; 2014 and Osemene, 2014). Most studies that used loan loss provision used return on capital employed (ROCE) as a proxy for performance (Osazevbaru, 2012). This study however used loan loss provision as the measure of earnings management because it is the best measure given the nature of the banking sector. In addition, this study uses return on assets as proxy for performance. The study focuses on finding the impact of earnings management practices on the ROA of deposit money banks in Nigeria.

This paper is divided into five sections. Section one, which is this, is the introduction, two is the literature review. Section three takes care of the methods used in conducting the study. Section four deals with the discussion of findings and five summarize and conclude the work.

Literature Review
Creative Accounting/Earnings Management
Creative accounting according to Ignacio (2009) is accounting practices that deviate from standard accounting practices. These practices are characterized by excessive compilation and the use of novel ways of manipulating income, assets or liabilities. Creative accounting has led to a number of recent accounting scandals, and many proposals for accounting reform that centered on an updated analysis of capital and factors of production that would correctly reflect how value is added (Osisioma and Enahoro, 2006). Creative accounting, as a matter of

approach, is not objectionable per se. However, when unethical elements make intrusion, the resultant accounting details becomes anything but true and fair. Creativity in such context is like referring to a half glass of water as half-full instead of describing it as half-empty. While both statements are factually correct, they paint different pictures and thus convey different images. Accountants can use their knowledge of accounting rules to manipulate figures reported in the financial statements of corporate enterprises. This process is referred to as cosmetic accounting. In the United Kingdom, it is often referred to as "creative accounting" (Naser, 1993 and Griffiths, 1986), in United States of America, it is called "earnings management" (Merchant & Rockness, 1994; Fisher & Rosenzweig, 1995).

Also as suggested Omurgonulsen (2009), creative accounting refers to accounting practices that seem to follow the letter of the applicable accounting standards but deviate from the spirit of those standards. The researchers noted that the motivation to indulge in these practices is anticipation of rewards which may include higher share prices, improved credit rating resulting in lower borrowing costs and higher incentive compensation for executive management. Some of the creative accounting schemes perpetrated by companies include improper revenue and expense recognition, faulty accounting in connection with business combinations, and wrongful use of off- balance-sheet arrangements. According to Chang, Shen & Fang (2008), these fraudulent schemes can be devastating to users like shareholders, lenders, employees, board of directors and other stakeholders.

Methods and Techniques of Earnings Management
Earnings management exists in numerous ways due to the volume of estimates that require judgment and experience in drawing up a set of periodic financial statements.
Income Smoothing: According to Mathews and Perera (1996), income smoothing is the process of deflating the reported profits of a business in good period and deferring them to loss making periods in an effort to portray a "stable income steam" over the years. This is possible because of the flexibility of matching concept, and investors prefer it as it purports a stable, strong and growing business. Also, that manager receives better in case of profit sharing scheme between managers and owners. Income smoothing can be separated into "real" and "artificial" smoothing, (Ujah & Brusa, 2011). In real smoothing, particular experience can be deferred to the following period e.g. advertising, while artificial smoothing is by way of shift in income through different policies from one period to the other e.g. depreciation method.

Window Dressing and Secret Reserves: According to Olatunji and Fakile (2012), Window Dressing and Secret Reserves involve the adjustment of financial statements of a company to achieve the maximum effect on the financial position at a particular date. This adjustment could be on any item on the balance sheet or profit and loss account. Example, a company may decide to inflate its sales by selling to its related company. This provision usually cushions the impact of such item on the profit when it actually takes effect. For example, provision for bad debt.

Off Balance Sheet Financing: This is a situation where total debts of a company increases but the increased borrowing is not reflected in the financial statements of the company, (kang & kim, 2011). That implies better gearing of the company than it actually is to enable it acquires more loan or funds. In such cases, the subsidiary with low gearing may be used to borrow for the parent with high gearing and the intercompany debts are eliminated at consolidation.

Pooling Versus Purchases Methods: Pooling is the accounting for a merger of two companies

where there is no goodwill created which increases future income because no amortization of good-will is needed. More so, all pre and post-acquisition reserves and earning are distributed to the shareholders. These features make pooling of interest a useful tool for earnings management in all forms of takeovers. The purchase method is unpopular because goodwill may be created and its amortization will decrease profit in future years. Moreover, only its post-acquisition profits are distributed to shareholders (Uwuigbe, 2013).

Many techniques of earnings management are used by banks. These techniques include the cookie jar reserve to show boom earnings in the future period. Big Bath technique (Li, 2011) are used in the belief that if a manager have to report bad news i.e. a loss from substantial restructuring, it is better to report it all at once and get it out of the way. Sometimes a subsidiary may underperform and the earnings of this type of security are managed by throw out a problem child method. Companies that changes GAAP have to take care that stock market does not view the change as lowering the quality of earnings. Timely disposition of long term productive assets (Sale/leaseback and asset exchange technique) can result in the recording of unrealized gains or losses. Under the amortization, depreciation and depletion method, management manages earnings by selecting the write off method & period & estimating salvage value. Companies do not have to report any gain or loss for repurchase of their own shares on the income statement because no income is recognized on the transaction (Shrink the ship). Other techniques according to Amat and Gowthorpe, 2004; Habib, 2005; Okike, 2009 and Ahmad, 2011 include cookie jar reserve, big bath, big bet on the future, flushing the investment portfolio and many others.

Bank Performance
According to Hossan and Habib (2010) performance is the degree of achievement of the mission at work place. Mostly researcher's used the term performance to express the range of measurements of transactional efficiency and input & output efficiency. Also Thachappilly (2009) indicated that profitability ratios designate a company's overall efficiency and performance. It measures the company use of its assets and control of its expenses to generate an acceptable rate of return.

As stated by Garg (2007) profitability ratio help to evaluate the performance of a company, so that investors can decide whether to invest in that company. Nevertheless, Cascio (2006) indicated that firm performance based on finance and accounting literature is measured by return on asset and ratio of sales to assets. In his contribution, Chenhall (2005) opined that performance of an organization can be measured either by financial or non-financial or both.

The concept of performance of the banks based on the financial ratio is applied by different researchers. Al-Tamimi (2009) determined some significant factors influencing performance of the UAE Islamic and Conventional National banks from 1996-2008. Using regression analysis, specifically ROE and ROA as dependent Variable, the researcher concluded that liquidity and concentration were the most significant determinants of conventional national banks. Conversely, number of branches and cost were the most influential factors of Islamic banks' performance.

In Malaysia, Sufian (2009) investigated the determinants of banks profitability in a developing economy during the period 2000-2004. The results showed that higher credit risk and higher loan concentration Malaysian banks face lower profitability level. On the contrary, Malaysian banks with higher level of capitalization, higher income from non-interest sources, and higher operational expenses face higher profitability level. Also, Okpara (2009) determined the major factors that influence the banking system in Nigeria. Using factor

analysis techniques, the author concluded that undue interference from board members, political crises, Undercapitalization, and fraudulent practices are considered the most critical factors that impact the performance of banking system in Nigeria. Furthermore, Elizabeth, Duncan and Elliott (2004) showed that all performance measures as interest margin, return on assets, and capital adequacy are positively correlated with customer service quality scores. Simply stated, much of the current bank performance literature describes the objective of financial organizations as that of earning acceptable returns and minimizing the risk taken to earn this return.

Review of Empirical Literature
Empirically, studies have been conducted on earnings management and financial performance of different sectors which are well documented in literature. In Nigeria, Ijeoma (2014) carried out a study to examine the effect of Earnings management in the Nigerian banking industry. Primary source of data collection was employed in this study and statistical tools used to analyze the data were the Kruskal-Wallis test and the multiple bar chart analysis. The result of this study revealed that the major reason for Earnings management practices in the Nigerian banking industry was to inflate the operating costs to reduce exposure to taxes and to maintain or boost the share price by reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend.
Abubakar, Abdu and Abdulmaroop (2014) empirically examine the impact of loan loss provision on earnings of deposit money banks in Nigeria using econometric analysis method on annual data of eight financial institutions over the period of 2006-2011. The results from the study state a positive relationship between provision for loan loss and earnings management in Nigerian DMBs. Similarly, Abubakar, Abdu & Abdulmaroop (2014) determine the effect of earnings management on the wealth of shareholders. Secondary source of data was used and analyses through correlation. The findings indicate that earnings management has negative relationship with shareholders wealth.

A study by Isenmila and Elijah (2012) examine the relationship between earnings management and auditor reporting for firms listed on the Athens Stock Exchange (ASE) for the post-IFRS period 2005–2009. According to the findings of the study, auditors, either Big 4 or non-Big 4, had weak incentives to prevent earnings management, and the audit opinion qualification was not issued in response to management's opportunistic behaviour. However, the study by Osazevbaru (2012) investigates the effect of earnings management on firm value in Nigeria used LLP as earnings management proxy and ROCE as firm value proxy. The study used regression and findings revealed that it can positively affect firm's value. Uwuigbe, Fagbemi and Anusiem (2012) investigate the practice of earnings management, its nature, techniques, and prevention. The findings of the study showed that the current GAAP in Nigeria created a gap that can permit the practice of earnings management, and also revealed that the new International Financial Reporting Standard will go a long way to reduce the practice, since it covers more areas that the former practice.

Accordingly, Gunny (2010) examines the future operating performance of firms that use earnings management to just meet earnings benchmarks. After controlling for size, performance growth opportunities, and industry, the study found that earnings management practices were positively associated with firms just meeting earnings benchmarks. Furthermore, Okike (2009), Ajibolade (2008) and Bakre (2007), have cited evidences of earnings management in the banking sector. The researchers highlight practical ways insiders perpetuates earnings management in order to present a false picture of firm performance, which is good. The findings of the studies highlighted an important link between investor

protection and the quality of accounting earnings reported to market participants, and complement both financial research that treat the quality of corporate reporting as exogenous. Akenbor & Ibanichuka (2002) evaluated the impact of earnings on the return on equity of manufacturing companies in Nigeria from 1999-2001. Secondary source of data was used. Operational risk was used as earnings management proxy. The findings show that earnings management does not significantly affect the return on equity of manufacturing companies.

The above reviewed studies (Anichebe; 2009 and Shehu and Abubakar, 2012) are vague and do not give an exact picture of earnings management. Studies that used loan loss provision have a different time period or were conducted in a different sector (Abubakar, Abdu & Abdulmaroop; 2014 and Osemene, 2014) and mostly used return on capital employed (ROCE) as a proxy for performance (Osazevbaru, 2012). This study is different in the use of its proxies and the time period. Thus, this study uses return on assets as proxy for performance in finding the impact of earnings management practices on the performance of deposit money banks in Nigeria.

Theoretical Framework
The theories used for the understanding of earnings management are underpinned by Resource Dependency, Agency Theory, Information Theory and Ethical Theory.

The theory upon which the study rests is the agency theory. Agency theory has its origins in the risk-sharing problem resulting from situations where co-operating parties have different viewpoints towards risks. This risk distribution problem is extended to contracting parties under the agency theory. The agency theory addresses agency associations in which one party called the principal gives work to another called the agent. The agency theory aims at resolving the agency problem and the risk sharing problem. The agency problem arises because in an agency arrangement the goal of the principal is at variance with that of the agent, and it is difficult or costly for the principal to monitor the activities of the agent. On the other hand, the risk-sharing problem occurs because the agent and the principal have different risk attitudes, and they will therefore act differently when faced with same risk. To resolve these conflicts, the agency theory proposes a contract that will lead to a goal-congruence between principal and agent.

From an agency theory viewpoint, earnings management is opportunistic. The dichotomy between owners and managers creates moral hazard and adverse selection challenges. These situations motivate managers to engage in earnings management. Furthermore, agency theory is been selected because it shows the relationship between the managers and the owners (shareholders) and other stakeholders. In an attempt to please the owners and also to show their efficiency in managing the owner's resources they tend to engage in earnings management practices.

Methodology
This study examines the impact of earnings management on the financial performance of listed Deposit Money Banks in Nigeria. The study uses an ex-post facto research design where the materials used are the published annual reports and accounts of the companies under consideration. The population comprises of all the fifteen listed DMB's on the floor of the stock exchange as at 31st December 2015. A total of five DMB's were selected using the judgmental sampling on the basis of the following: Banks with regular annual report and account for the study period. This is because the bank without consistent financial report covering the period under consideration will invalidate the findings of the study. According

to Kabir (2002) firms without regular financial report will distort the conclusion of the research if selected as part of the sample. Also, banks were selected based on availability of the required data for the study.

After the application of the above filter, only banks with data for the period were included in the sample and these comprise the following banks: Access bank Plc, Fidelity Bank, Sterling Bank, United bank for Africa Plc and Zenith Bank.

Data were collected from the annual reports and accounts of the banks covering a five year period 2011-2015. Considering the nature of the data which is time series, the study therefore employs multiple regressions using pooled OLS regression. This is in accordance with the work of Roman (2009). A simple model was employed to determine the impact of earnings management on Performance of DMBs. The quality of earnings management could be estimated as a function of the firm's agency characteristics, which have been defined in this study as loans loss provision.

This is expressed as EM = f (LLP).

The panel data regressions that are used to estimate the relationship are as follows:

ROA=α_0 + α_1DAC+ α_2 SIZE + α_3 AGE + e as adopted from the work of James (2009) but was modified in this study because of the fact that the sector under consideration is deposit money banks which differ from the sector studied by (James, 2009). The modified model is therefore as follows:

ROA=α_0 + α_1LLP$_{it}$+ α_2 SIZE$_{it}$ + α_3 AGE$_{it}$ + e$_{it}$

Where:

ROA=return on asset

SIZE = natural logarithm of total assets

AGE = the number of years since the listing of the firm to the observation date

LLP=loan loss provision

α_1 = Parameters to be estimated (is the average amount the dependent variable increases when the independent increases by one unit).

e = an error terms assumed to satisfy the standard regression assumption.

Data Presentation and Discussion of Results

This section deals with the presentation, analysis and interpretation of the results on the effect of earnings management on the financial performance of deposit money banks in Nigeria. It also discusses the results so that inferences can be drawn. A set of descriptive statistics is first presented, followed by the correlation and regression results.

Table 4.1 Descriptive Statistics of the Data

Variables	Observations	Mean	Standard deviation	Minimum	Maximum
ROA	25	1.6108	.9949453	-.99	3.93
SIZE	25	21.0996	.5684151	20.04	22.05
AGE	25	19	13.10216	6	45
LLP	25	0.01528	0.0222589	0.001	0 .11

Source: Computed by the Researchers Using Stata 11.1

Table 4.1 shows that ROA has a mean of 1.6108 with standard deviation of 0.9949453, minimum and maximum values of -0.99 and 3.93 respectively. It is also evidence from the table 4.1 that SIZE of the banks has a mean of 21.0996 with 0.5684151 as standard deviation and 20.04 and 22.05 as minimum and maximum values respectively. Table 4.1 also revealed that the mean AGE of the DMBs is 19 years with 13.10216 as standard deviation

and 6 years and 45 years as minimum and maximum respectively. Lastly, the table 4.1 shows that, averagely, LLP for DMBs in Nigeria is 0.01528 with the standard deviation of 0.0222589, minimum and maximum values of 0.001 and 0.11 respectively.
From the table it can be seen that ROA has the lowest mean of 1.6108.

Table 4.2: Correlation Matrix Of The Variables

	ROA	LLP	SIZE	AGE
ROA	1.0000			
LLP	-0.3424	1.0000		
SIZE	0.4229	-0.4458	1.0000	
AGE	0.0345	-0.2973	0.1578	1.0000

Source: Computed by the Researcher Using Stata 11.1

Correlation matrix shows the relationship between explanatory variables and explained variable and also the relationship among the individual variables themselves. The correlation matrix is also an alternative test for multicollinearity. Gujarati (2004) notes that correlation above 0.8 between variables, is a concern as it indicates excessive correlation. From the correlation table, the results reveal only a mild correlation among the independent variable which indicates that the model performs well.
It can be seen from table 4.2 above that ROA has a positive relationship with SIZE and AGE. The relationship between ROA with SIZE and AGE are (r=0.4229) and (0.0345) respectively. From the table it can also be deduced that LLP has a negative relationship with both SIZE and AGE while the relationship between SIZE and age is positive.

ROA and the explanatory variables
To be able to measure the relationship that exists between ROA with LLP, SIZE and AGE, the study used pooled OLS regression. However, in order to ensure that proper, adequate, reliable and effective regression result is used in this research to determine the impact of earnings management on ROA, both fixed effect regression result and random effect regression result were subjected to hausman test. From the hausman test, it was found that the appropriate and consistent regression result to be used in this research is random effect regression result. This is because the hausman test shows that the variables are more correlated under random effect, at such random effect regression result is shown in table 4.3.

ROA and Explanatory Variables (LLP, SIZE and AGE)
Table 4.3 Pooled Regression Result (ROA=α_0 + α_1LLP+ α_2 SIZE + α_3 AGE + e)

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-----------------------------------------------------------------------
roa |    Coef.  Std. Err.    z   P>|z|   [95% Conf. Interval]
-------+---------------------------------------------------------------
llp |  -3.721977  8.104265  -0.46  0.646  -19.60605   12.16209
size|   1.019422  .3636987   2.80  0.005   .3065856   1.732258
age |  -.0323075  .0153016  -2.11  0.035  -.0622981  -.0023168
cons|  -19.22788  7.71518   -2.49  0.013  -34.34935  -4.106406
-------+---------------------------------------------------------------
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Source: Stata 11.1
R-square: = 0.4711
Wald chi2 (3) = 13.27
Prob> chi2 = 0.0041

From table 4.3 above, the overall aggregate influence of the explanatory variables included in

the model are able to explain ROA up to 0.4711 (47%) which is indicated by R-square (overall), while the remaining 53% are controlled by other factors that are not included in the model. The P-value of 0.0041 and significant at 5% which is statistically significant shows that the model is well fitted and therefore provides substantial evidence that ROA is negatively related with earnings management in DMBs in Nigeria.

Table 4.3 further reveals that there is a Negative relationship between LLP and ROA having coefficient of -3.721977 with a z-value of -0.46. This implies that an increase in ROA leads to 3.721977 decrease in earnings management. The result indicates that banks plan to maintain almost the same percentage of ROA during the sample period. SIZE and ROA exhibit a positive interaction having coefficient of 1.019422and z-value of 2.80 which signifies that an increase in the SIZE results to an increase in ROA by 1.019422. The result further reveals a negative relationship between ROA and AGE having a coefficient of-0.0323075 and a z-value of -2.11 implying that a rise in bank AGE results in a fall of ROA by0.0323075.

SIZE positively relates with ROA. This opposes the view that because large banks have more resources than their smaller counterparts they are more likely to avoid the use of ROA to manipulate reported earnings. On the contrary, because of the pressure exerted on large banks by their stakeholders, banks have incentive to manage earnings to please their complex Stakeholders.

From the results, the negative association between earnings management (LLP) and ROA suggests that banks decrease ROA to manage (smooth) earnings. This result is in line with the findings of Anichebe (2009), Shehu & Abubakar (2012) and Abubakar, Abdu & Abdulmarooph (2014). The findings of Murya (2010) do not agree with this finding.

It is therefore concluded in this study that bank managers intend to use earnings management to manipulate their reported performance when they have low ROA.

ROE.

Test of Hypotheses

Based on the above regression results obtained from table 4.3, the hypotheses of this study will be tested.

Table 4.3 regression result was used to test the first hypothesis which states that "earnings management does not have significant impact on the return on assets of DMBs in Nigeria'. The result shows that the individual P value of LLP =0.646 (64.6%) at 5% significant level indicates that LLP (earnings management) does not have significant impact on ROA. This is supported with the overall R square of 0.4711(47.11%) which shown that there are 53% other variables which affect the ROA of DMBs. Based on this result; the first hypothesis which stated that "earnings management does not have significant impact on ROA" is therefore accepted.

Conclusion and Recommendation

The study examines the impact of earnings management on the performance of listed deposit money banks in Nigeria. Earnings management is an activity where managers use their discretion to mislead stakeholders about the economic performance of the company or to influence contractual outcomes. Earnings management practices include: recognizing premature or fictitious revenue, aggressive capitalization and extended amortization policies, misreported assets and liabilities, getting creative with income statement and problems with cash flow reporting. From the above findings which show the impacts of earnings management on key performance indicator (ROA), it can therefore be concluded that earnings management have impacts on the performance of DMBs in Nigeria, though the

impacts is not significant. The overall findings showed that there is existence of earnings management in Nigeria's deposit money banks. It is however pertinent to note here that the existence of earnings management in DMBs in Nigeria does not have significant impact on their performance as inferred from the findings of this research.

It is therefore recommended that, even though the relationship between the variables is not significant, appropriate and proper measure should put in place for adequate evaluation, examination and scrutinisation of DMBs financial statement and adequate procedures for early detection of earnings management practices should also be put in place before earnings management practices will have a great and notable negative impacts on their performance. Also, the Nigerian Accounting standard Board (NASB) should be empowered to draft a well-structured framework of accounting regulation, accept, review and investigate financial statements of all DMBs quoted on the NSE to ensure compliance with GAAP, IFRS, CAMA and other financial reporting Act.

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