

Earnings Management and Quality of Corporate Governance in Nigeria: A Review of Executive Compensation and Audit Committee Characteristics

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Abstract

Earnings management is a mechanism used by corporate managers to take advantage of the flexibility in accounting principles to influence reported earnings or assets, thereby causing reported income to be larger or smaller than it would otherwise be. This study was carried out to examine the relationship between earnings management and quality of corporate governance in Nigeria. The study adopted the content analysis research design and data were obtained from financial statements of sampled companies. The population of the study consists of all companies listed in the Nigeria Stock Exchange. The study using data from annual reports of manufacturing companies for the period 2012 to 2016 analyzed some simple descriptive and correlation statistics and used regressions to examine the relationship between the variables highlighted in the study. The study showed that quality of corporate governance, audit committee strength and executive compensation have a significant negative relationship with earnings management. The study therefore concludes that good corporate governance practice has a significant effect in reducing earnings manipulations which by extension improves on quality of financial reporting and recommends amongst others that audit committees should be strengthened by emphasizing independence and active participation of members in meetings.

Keywords: Earnings Management, Corporate Governance, Executive Compensation, Audit Committee.

Introduction

The revelations of unethical accounting behavior by members of board of directors of big corporations around the world which ultimately led to the collapse or takeover of many companies have raised many questions about the credibility of accounting profession and the effectiveness of governance structures meant to monitor corporate boards. In Nigeria, the incidence of creative accounting and window dressing practices has brought about corporate

scandals resulting in failure of companies such as Cadbury, Lever Brothers, Oceanic Bank, Afribank, Intercontinental Bank etc (Enofe, Mgbame, Otuya & Ovie, 2013). In most of the Nigerian scenarios, the crux has always been financial scandals bordering on cooking the books in order to mislead the gullible stakeholders. This has thus drawn increasing attention to the corporate financial reporting in both developing and advance economies.

The accounting profession supports the exercise of judgments in preparation of financial statements. The Generally Accepted Accounting Principles (GAAP) and indeed the International Financial Reporting Standards (IFRS) which is adopted in Nigeria create opportunities for managers to choose reporting methods and estimates that do not accurately reflect their firms' underlying financial performance. In view of the foregoing, managements' use of judgment also gives room for "earnings management", in which managers use the methods they deem suitable to prepare and present accounting reports. Hence, earnings management arises as a result of managers having the capacity to exercise discretion over certain accounting decisions by exploiting the loopholes in the accounting standards.

Earnings management is a mechanism used by corporate managers to intentionally alter financial statements results, i.e income statement, statement of financial position and statement of cash flows, in some desired amount and/or some desired direction with the view to systematically misrepresent the true income and assets so as to mislead some stakeholders or to influence contractual outcomes. It implies the use of the flexibility in accounting principles that allow managers to influence reported earnings, thereby causing reported income to be larger or smaller than it would otherwise be (Wallace & Pornsit, 2004; Hamidreza, Davood & Elmira, 2012; Fauzi & Mohammed, 2012). Sherry, McDowell and Erin (2010) postulate that organizations manage reported earnings for three main purposes, namely, to avoid losses, to avoid earnings decreases, and to meet analysts' earnings expectations.

Earnings management is permissible if the reported earnings are adjusted in accordance with the generally accepted accounting principles such as altering the methods for inventory valuation and depreciation. Earnings management is however considered a fraudulent activity when it does not conform to accounting principles like accelerating revenue recognition and deferring expenses recognition (Yang, Chun, & Ramadili, 2009). As a result of this, studies have classified the earnings management objective into two categories namely: beneficial and opportunistic objectives. A situation where earnings management improves the information value of earnings by conveying private information to the shareholders and the other stakeholders is termed beneficial whereas, opportunistic earnings management emanates from capitalising on the gaps in the accounting standards intended to deceive stakeholders (Jirapon, Miller, Yoon, & Kim, 2008; Siregar & Utama, 2008).

The need for a good corporate governance mechanism becomes expedient to promote corporate transparency through the availability of relevant and reliable information about the financial performance, position, investment opportunities, governance, value and risk of the firm. Corporate governance is the combination of mechanism to ensure that the management (the agent) runs the firm for benefit of one or several stakeholders (principal), such may cover stakeholders, and other different types of stakeholders (mainly the large shareholders and minority shareholders) in prevention of these conflicts of interest. The existence of conflict of interest between managers and owners naturally compromises the value of the firm and only transparency can eliminate the conflict (Cadbury, 1992; OECD, 1999; Ahmed, 2006; Otuya & Ofeimun, 2017)

Statement of Problem

Earnings management has been a subject of debate by accounting practitioners and scholars in recent times. The considerable attention accorded to earnings management could be

attributed to the importance users of financial information attach to earnings since earnings are widely believed to be the primary information that existing and potential investors watch out for in a financial statement.

According to Mohammady (2012), the chief interest in financial reporting is the earnings quality, which is part of the overall financial reporting quality. It plays a significant role in the usefulness of earnings in decision making process and is an important subject today because of the reliance of capital markets on credible financial reporting specifically income statement. McNichols (2000) further corroborate this by stating that the most important accounting item prepared and presented in financial reports is the—Earnings which is considered as a crucial factor in determining the dividend policy, a guideline for investment and decision making, a core measure of a firm's performance, an effective criterion in the stock pricing and eventually an instrument utilized to make predictions.

In order to improve corporate governance in Nigeria, the Securities and Exchange Commission, in September 2008, inaugurated a National Committee for the review of the 2003 Code of Corporate Governance for Public Companies in Nigeria to address its weaknesses and to improve the mechanism for its enforceability. In spite of the corporate governance codes and principles stipulated by the Security and Exchange Commission (SEC, 2008), there is still the argument in the literature as to whether the introduction of governance codes eliminates or reduces the practice of earnings management by Nigerian companies.

Previous studies (Ejeagbasi & Nweze, 2015; Omoye & Eriki, 2014; Ugbede, Lizam, Kaseri, 2013; Egbunike, Ezelibe & Aroh, 2015; Uadiale, 2012) conducted in Nigeria have tackled the issues of corporate governance and earnings management with divergent and mixed results. A number of the previous studies have placed more emphasis on corporate governance variables such as board size, composition, independence and audit committee characteristics. However, less attention has been paid to the linkage between corporate governance quality, executive compensation and earnings management. The current study fills this gap in the literature by providing evidence about the effect of corporate governance quality, executive compensation and audit committee strength on earnings management in Nigeria.

Arising from our research problems above are the following specific research questions:

1. How is the Quality of Corporate Governance system related to earnings management in Nigerian companies?
2. What impact does Audit Committee Strength have on earnings management in Nigerian companies?
3. What is the relationship between Executive Compensation and Earnings Management in Nigerian companies?

Literature Review and Hypotheses Development

Quality of Corporate Governance System and Earnings Management

Corporate governance is not an entirely new notion in the Nigerian corporate environment. The Companies and Allied Matters Act, 1990, the Bank and other Financial Institutions Act, 1991 (as amended) the Investment and Securities Act, 1999 (as amended), the CBN Act, 2006, the Securities and Exchange Commission Act, 1988, 2004 and 2008 (as amended) have a number of corporate governance provisions in them (Ejুবekpokpo & Esuiké, 2013; Ofeimun & Otuya, 2017). There has also been an increase in level of awareness of corporate governance issues in Nigeria (Uadiale, 2012; Omoye & Eriki, 2014; Isenmila & Afensimi, 2012). The contentious issue however, is the quality of corporate governance in terms of the level of compliance by managers of businesses. We exploit this gap to examine whether

corporate governance quality has a direct impact on earnings management by using the Nigeria's revised code of governance 2008 to test the quality of corporate governance in practice by sampled firms.

Corporate Governance assessment indices (G-Index), which are used to evaluate corporate governance quality, have been adopted in a number of studies. Studies such as (Gompers, Ishii, & Metrick, 2003; Bowen, Rajgopal & Venkatachalam 2003; Sivaramakrishnan & Yu, 2008) employed G-index to examine the effect of corporate governance quality on earnings management and found no significant relationship between the corporate governance quality and earnings management. Abbadi, Hijazi and Al-rahahleh (2016) in their study found a negative relationship between corporate governance quality and earnings management. Beasley (1996), Klein (2002) and McMullen (1996) have shown that good governance reduces the adverse effects of earnings management as well as the likelihood of creative financial reporting arising from fraud or errors. Egbunike, Ezelibe and Aroh (2015) findings show that corporate governance practices such as the board size, firm size, board independence, and strength of the audit committee have significant influence on earnings management practices among Nigerian quoted companies. Following the above, we therefore assume in this study that quality of corporate governance does positively affect earnings management.

Hypothesis One: There is no significant positive statistical relationship between quality of corporate governance and earnings management.

Audit Committee Strength and Earnings Management

The responsibility of the audit committee has evolved over the years. The objectives of having an Audit Committee in the corporate governance structure include enhancing the credibility of financial reports, encouraging audit independence and supporting directors in meeting their responsibilities (Bradbury, 1990). Good corporate governance practice dictates that members of the audit committee command high level of financial competencies. This is because of their oversight function of internal control and financial reporting. It is in furtherance of this that the Blue Ribbon Committee (1999) recommended that each member of the audit committee should be financially literate and that at least one member should have accounting or related financial management experience, where 'experience' is defined as 'past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a CEO or other senior officer with financial oversight responsibilities'.

Prior studies on audit committee characteristics and earnings management have thrown up distinct results. Bedard, Chtourou and Courtead (2004) reported that presence of audit committees with financial expertise in the United States can prohibit earnings management. Another study by Agrawal and Chadha (2005) pointed out that audit proficiency can prevent fraud and manipulated earnings, which are measures that affect earnings management. Ghosh, Marra and Moon (2010) reported that earnings management does not vary with board composition and structure, or with audit committee composition, expertise, and ownership. In contrast, board size and audit committee size, activity, and tenure are associated with earnings management. Liu, Harris and Omar (2013) opined that independence of audit committee, the frequency of meetings and the presence of nomination committee are negatively related to earnings management. Following the above, we hypothesize that the audit committee strength will have no positive relationship with earnings management.

Hypothesis Two: There is no significant positive statistical relationship between Audit Committee Strength and Earnings Management in Nigerian companies.

Executive Compensation and Earnings Management

The efficient market hypothesis postulates that capital market mechanisms affect the value and executive pay directly (Chu & Song, 2012). This in effect implies the absence of a positive link between executive compensation and performance if the market is inefficient. Edmans and Gabaix (2009) assert that company executives may apply earnings management to signal to the market, to increase executive compensation and investment. They maintain that in a setting where information asymmetry is prevalent, top executives may use earnings management to increase short-run stock prices, which is closely linked to their reward packages. Conversely, earnings management raise the expectations of the outside shareholders for higher dividends based on manipulated earnings figures on the financial statements. Shehu (2011) opines that corporations with high executive-equity ownership interest are less likely to manage earnings for short term private gains at the expense of outside shareholders and that corporate management whose interest is consistent with shareholders is more likely to report earnings that reflect the underlying economic value of the firm

A number of studies in the finance literature have pointed out that executive compensation packages are a result of discretionary accruals, which inflate earnings and stock prices. Man and Wong (2013) in a study observed evidence that the compensation committee makes decisions related to discretionary expenditure in the executive's terminal year when setting cash compensation for executives, and intervenes to minimize payments when managers make up accruals. Abdelgeny (2005) stated that earnings smoothing occurs at the period of management change either as a result of termination of appointment or end of tenure when many irregularities are done. Consequently, a new CEO may shift part of the income to the time he will be evaluated and appraised. Epps and Ismail (2009) pointed out that firms with annually elected boards, small size boards, 100 percent independent nominating committees, and 100 percent independent compensation committees have more negative discretionary accruals. Kuhnen and Zwiebel (2008) state that the use of executive compensation as one of managerial entrenchment mechanisms is prevalent in firms with separation of owner and control. Therefore, there are questions on whether firms inflate earnings, and increase executive compensation and investments where there is a prevalent problem of information asymmetry.

Mixed results have been reported on the relationship between earnings management and executive compensation. Chen and Li (2011) find that executive compensation in shares is positively associated with the absolute value of discretionary accruals. Ben Hassen (2014), Sun and Hovey (2012), Brown and Lim (2012) reported a negative relationship between earnings management and executive compensation. Studies on executive compensation and earnings management are rare in Nigeria hence the motivation for this study. In light of these theoretical and empirical developments, we test the following hypothesis:

Hypothesis Three: There is no significant positive statistical relationship between Executive Compensation and Earnings Management in Nigerian companies.

Methodology

Research Design

This study adopts the content analysis research design. Content analysis is a research technique used to make replicable and valid inferences by interpreting and coding textual

material (Simon & Goes, 2013). This study involves the analysis of corporate financial statements hence this research design is considered suitable for it.

Population and Sampling

The population of the study is made up of all 82 manufacturing firms listed on the Nigerian Stock Exchange as at 31st December, 2016 (NSE Market Report, January 9, 2017). The population is classified into four subsectors namely the foods and beverages (17), Building Materials (16), chemicals and Paints (11) and other Conglomerates (38). Based on this population, a normal confidence level of 95% and error tolerance of 0.05% was used. The final sample size for this study was based on Yamane's formula (1967).

The statistical formula is stated, thus: $n = \frac{N}{1 + N(e^2)}$

Where: n = sample size

N = Population size

e = Level of significance desired.

Given that: $N = 82$ and $e = 0.05$, the sample therefore = $\frac{82}{1 + 82(0.05^2)}$ which gives a sample size of 68 firms. A stratified sampling method was further adopted so as to give a proper representation to each group in the ratio of (38:17:16:11) using proportionality formula.

Thus: $S = A/N(n)$.

Where

S = No of Corporate Financial Statements used for each group

A = the population of each group

N = total population of all the manufacturing firms

n = estimated sample size used in the study

Thus the breakdown of the sample size is given in the table below:

Table 01: Break down of the Sample Size

GROUPS	POPULATION	FINANCIAL STATEMENTS
Foods and Beverages	17	14
Building Materials	16	13
Chemicals and Paints	11	9
Other Conglomerates	38	32
TOTAL	82	68

SOURCE: Researchers' Field Survey, 2017

Method of Data Collection and Analysis

Secondary data were used for the study. The secondary data were retrieved from financial statements of the sampled manufacturing firms for the period 2012 – 2016. The study made use of the Ordinary Least Square (OLS) regression analysis as the data analytical method. Prior to the regression analysis, some diagnostic tests were carried out to address some basic assumptions underlying the regression analysis.

Empirical Model

In order to achieve the objective of the study, a liner and multivariate regression model which expresses earnings management as a function of corporate governance quality, executive compensation and audit committee characteristics is stated in functional form as follows:

$$DACC = f(GOVQTY, EXEPAY, AUDCOM)$$

This can be written in explicit econometric form as:

$$DACC_{it} = \beta_0 + \beta_1 GOVQTY_{it} + \beta_2 EXEPAY_{it} + \beta_3 AUDCOM_{it} + \varepsilon_{it}$$

Where:

DACC: the absolute value of discretionary accruals; GOVQTY: Corporate Governance Quality; EXEPAY: Executive Compensation; AUDCOM: Audit Committee Strength.

ε = Error term; i = Manufacturing firms; t = Time dimension of the variables

β_0 = Constant or Intercept; β_{1-3} = Coefficients to be estimated or the Coefficients of slope parameters.

Description of Variables

Dependent Variable: To measure the earnings management of the firms in the study, the Discretionary Accruals (DACC) used by management was chosen. Based on this view, the higher the level of DACC, the greater the distance between the financial performance and results shown in the financial statements. Thus, the higher the earning management the lower the quality of the financial information presented by the firm.

A prominent study by Dechow, Sloan and Sweeney (1995) in the earnings management literatures shows five models of discretionary accruals in an evolutionary manner: the Healy Model (1985); the DeAngelo Model (1986); the Jones Model (1991); the Modified Jones Model (1995). Dechow, Sloan, and Sweeney (1995) are of the view that based on the competing models, discretionary accruals should be estimated by subtracting predicted level of nondiscretionary accruals from total accruals (standardized by lagged total assets):

Dechow, Sloan, & Sweeney (1995) argue that the rationale for the original Jones Model is to remove the inferred tendency of the Jones model to measure discretionary accruals with error when discretion is exercised over revenues. Thus, consistent with contemporary studies in earnings management, the Modified Jones Model is adopted to estimate the discretionary accruals because it advances on the errors of the original Jones Model. Discretionary accrual (DACC) is defined as the residual from the regression of total accruals on non-discretionary accruals as given in the cross sectional model:

$$TACC_{it} = NI_{it} - CFO_{it} \dots\dots\dots (i)$$

Thus the industry specific parameters of the Jones model are estimated as follows:

$$TACC_{it} / TA_{it-1} = \alpha_1 (1/TA_{it-1}) + \alpha_2 [(\Delta REV_{it})/TA_{it-1}] + \alpha_3 (PPE_{it} / TA_{it-1}) + \varepsilon_{it} \dots\dots\dots (ii)$$

Non-discretionary accruals are measured using the equation as follows:

$$NDACC_{it} = \alpha_1 (1/TA_{it-1}) + \alpha_2 [(\Delta REV_{it} - \Delta REC_{it})/TA_{it-1}] + \alpha_3 (PPE_{it} / TA_{it-1}) \dots\dots\dots (iii)$$

The Difference between total accruals and the non-discretionary components of accruals is considered as discretionary accruals as stated in equation as follows:

$$DACC_{it} = TACC_{it} - NDACC_{it} \dots\dots\dots (iv)$$

Where:

TACC = Total Accruals; NI = Net Income before Extraordinary Items; OCF = Operating Cash Flows; TA_{-1} = Previous year's total assets; ΔREV = Change in Operating Revenues; PPE = Gross Property, Plant and Equipment; NDACC = Non-discretionary Accruals; ΔREC = Change in Net Receivables; DACC = Discretionary Accruals; $\alpha_1 - \alpha_3$ = Regression Parameters and ε = error term.

Independent Variables: The independent variables for this study are (1) Executive Compensation is measured as total compensation paid to the directors for the year. This compensation includes a fixed salary, annual bonus and severance pay. We transformed this variable using the natural logarithm to reduce the dispersion in the distribution of compensation paid to executives.

(2) Audit Committee Strength is also measured in terms of audit committee independence

(proportion of independent directors in audit committee) and audit committee activities (number of times meetings are held).

(3) Corporate Governance Quality which is measured based on governance index used by (Abbadi, Hijazi & Al-rahahleh, 2016) in measuring corporate governance quality. The model was modified and adjusted to align with the revised code of best practices in Nigeria by the Securities and Exchange Commission (SEC, 2008) taking cognizance of the Nigerian business environment. The governance index is classified into four categories with a total of 10 standards as shown in the table below:

Table 02: Corporate Governance Quality Index

CATEGORY	GOVERNANCE STANDARD	RULE IN CORPORATE GOVERNANCE CODE
Board of directors	1) Members of board of directors are not less than five.	The Board is accountable and responsible for the performance and affairs of the company.
	2) It should comprise a mix of executive and non-executive directors	The majority of Board members should be non-executive directors.
	3) Chairman and CEO positions are separated	The position of the chairman of the Board and the chief executive officer shall be separate and held by different individuals.
Board meetings	4) Disclosure about number of the board meetings	The Board should meet at least once every quarter.
	5) Records about Board members attendance	Every director should be required to attend at least two-thirds of all Board meetings.
Audit	6) Existence of Audit Committee	Every public company is required under section 359(3) and (4) of the CAMA 1990 to establish an audit committee.
	7) Members of the Audit Committee are not less than six.	The composition of audit committee shall be equal number of directors and shareholders subject to maximum of six (6) members.
	8) Disclosure of frequency of Audit Committee meetings	The Committee shall meet regularly; there should be no fewer than three meetings during the year.
	9) Expertise of Audit Committee	Members of the committee should have basic financial literacy and should be able to read financial statement. At least one member should have knowledge of accounting or financial management.
Compensations	10) Existence of Compensations Committee	Remuneration committee which should comprise solely of non-executive directors. Make recommendations on compensation structure for executive directors

Source: Extracted from Revised Nigeria's Code of Corporate Governance (SEC, 2008)

Data Analysis and Results

Table 03: Descriptive Statistics of the Variables

	DACC	AUD IND	AUD ACT	COGQUA	DIR REM
Mean	-.5578	2.7059	3.7500	7.6029	209.27
Maximum	.0453	3.00	5.00	10.00	933.00
Minimum	-.9390	2.00	1.00	5.00	23.00
Std. Dev.	.3223	.4590	1.2503	1.7289	274.05

Observations	68	68	68	68	68
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Note: The values of directors' compensation are in millions.

KEY: DACC= Discretionary Accruals; AUD- IND= Audit Independence; AUD -ACT =Audit Activity; COGQUA=Corporate Governance Quality; DIR-REM =Directors Remuneration.

The table above gives details of the descriptive statistics. From the table it can be observed that the DACC has a mean of -0.5578. The maximum and minimum values are 0.0453 and -0.9390 respectively with a standard deviation of 0.3223. The negative mean recorded in the distribution implies that the majority of the sampled firms recorded a negative total accrual. This situation arose due to the average operating cash flow being more than the average net income because much expenses have been deducted from income and have not been included in the operating cash flow such as depreciation and amortization. The standard deviation measuring the spread of the distribution is high and indicates considerable dispersion from the mean and that the distribution is inclusive of companies with significant variations in their accrual level.

The descriptive statistics also shows that on the average, audit independence and audit activity have 2.7059 and 3.7500 respectively. The maximum and minimum values are 3(2) and 5(1) respectively for audit independence and audit activity. The implication is that on the average, audit committee in our sample consists of less than equal number of directors and shareholders subject to maximum of six as stipulated in the Nigerian Code of Corporate Governance. However, the mean value for audit activity implies that most sampled firms meet the requirement of audit committee meeting no fewer than three times during the year. The standard deviation also stood at 0.4590 and 1.2503 respectively. The standard deviation for AUD IND is low indicating that there is not much deviation among the companies sampled in terms of proportion of independent directors in the audit committee. However, the standard deviation for AUD ACT is high compared to the mean value which means that there are significant variations in the number of times audit committee members hold meetings during the year.

Quality of corporate governance (COGQUA) has a mean of 7.6029. The maximum and minimum values are 10 and 5 respectively. Two companies meet all overall (10) categories of standards of governance index. However, none of the sampled firms recorded below 5 governance standards as observed in the minimum value of COGQUA. The standard deviation of 1.7289 also shows a significant disparity among the firms in terms of adherence to corporate governance codes.

Finally, the DIR-REM has a mean of 209.27 million naira. The minimum and maximum values are 933 and 23 million naira respectively with a standard deviation of 274.05. The standard deviation measuring the spread of the distribution is low from the mean but high from the maximum and minimum values indicating considerable dispersion in the amount paid out to executives of the sampled firms as remunerations.

Table 04: Correlation of the Variables

		DACC	AUD IND	AUD ACT	COGQU A	DIR REM
DACC Correlation	Pearson	1				
	Sig. (2-tailed)	.68				
	N					
AUD IND Correlation	Pearson	-.479*	1			
	Sig. (2-tailed)	.000				
	N	68	68			
AUD ACT Correlation	Pearson	-.525*	.156	1		
	Sig. (2-tailed)	.000	.204			
	N	68	68	68		
COGQUA Correlation	Pearson	-.666*	.584*	.485*	1	
	Sig. (2-tailed)	.000	.000	.000		
	N	68	68	68	68	
DIR REM Correlation	Pearson	-.562	.286*	.202	.297*	1
	Sig. (2-tailed)	.000	.018	.098	.014	
	N	68	68	68	68	68

*Correlation is significant at the 0.05 level (2-tailed)

KEY: DACC= Discretionary Accruals; AUD- IND= Audit Independence; AUD –ACT =Audit Activity; COGQUA=Corporate Governance Quality; DIR-REM =Directors Remuneration.

Table 04 gives the Pearson correlation matrices of the variables in our sample. None of the variables shows significant high correlations among each other. Consistent with Neter, Wasserman and Kutner (1998), simple correlation between independent variables should not be considered harmful until they exceed 0.80. The correlation statistics shows that DACC has a negative relationship with AUD IND ($r=-.479$), AUD ACT ($r=-.525$), COGQUA ($r=-.666$) and DIR REM ($r=-.562$). The implication is that good corporate governance quality, independent audit committee, active audit committee and better executive remuneration reduces earnings manipulations. The correlation also indicate that audit independence (AUD IND) has a positive link with AUD ACT ($r=.156$), COGQUA ($r=.584$) and DIR REM ($r=.286$). This also implies that audit independence enhances active audit committee, improves corporate governance quality and executive compensation. The statistics also indicate presence of positive relationship between audit activity and quality of corporate governance ($r=.485$) and executive compensation ($r=.202$). Finally, the table shows a positive correlation between COGQUA and DIR REM ($r=.297$).

Analysis of Findings

The results of findings through testing the various hypotheses formulated using the regression analyses are present below:

Hypothesis One: There is no significant positive statistical relationship between quality of corporate governance and earnings management.

Table 05: Regression Statistics for COGQUA and Earnings Management

MODEL	SS	DF	MEAN ²	F	SIG	R	R ²	ADJ. R ²	SEE
1 Regression	3.085	1	3.085	52.5	.000(a)	.666(a)	.443	.435	.242
Residual	3.875	66	0.59	5					
Total	6.961	67							

- a) Predictors: (Constant), Corporate Governance Quality
b) Dependent Variable: DACC

The summarized regression results show that the multiple regression models are significant. The co-efficient of determination or R² is .443. This shows that about 44 percent of the variations in the dependent variable of the model is explained by the variations in the independent variables. Also, the f-ratio of 52.55 shows that the predictor variables are very significantly related with the response variables. From the correlation table, the coefficient of correlation is -.666 while the p-value is 0.000. This signifies a negative relationship. The p-value of 0.000 also implies the rejection of the null hypothesis and therefore states that there is a significant negative relationship between quality of corporate governance and earnings management.

Hypothesis Two: There is no significant positive statistical relationship between Audit Committee Strength and Earnings management.

Table 05: Regression Statistics for AUDCOM and Earnings Management

MODEL	SS	DF	MEAN ²	F	SIG	R	R ²	ADJ. R ²	SEE
1 Regression	3.085	2	1.542	27.29	.000(a)	.676(a)	.456	.440	.237
Residual	3.673	65	0.57						
Total	6.758	67							

- a) Predictors: (Constant), Audit Activity, Audit Independence.
b) Dependent Variable: DACC

Table 05 presents the results of estimating regression models for audit committee strength and earning management. The regression statistics indicates that the R square value is 0.456, which indicates that 45.6% of the variation in the dependent variables is explained by the independent variables while 54.4% of the variation is explained by other factors outside the model and the error term. The R-value is 0.676, which indicates a strong correlation between the dependent and the independent variables. Further, results presented in correlation matrix show a negative relationship for Audit Independence (r=-.479) and Audit Activity (r=-.525). This is used as evidence to state that there is a negative and significant relationship between audit committee strength and earnings management.

Hypothesis Three: There is no significant positive statistical relationship between Executive Compensation and Earnings management.

Table 06: Regression Statistics for EXEPAY and Earnings Management

MODEL	SS	DF	MEAN ²	F	SIG	R	R ²	ADJ. R ²	SEE
1 Regression	2.151	1	2.151	30.82	.000(a)	.564(a)	.318	.308	.264
Residual	4.607	66	0.070						
Total	6.758	67							

a) Predictors: (Constant), Directors' Remuneration

b) Dependent Variable: DACC

The regression analysis indicates that we can explain 31.8% of the discretionary accrual practices using information provided by directors' remunerations (EXEPAY) (Table 06). In table 04, the Pearson correlation coefficient ($r = -0.562$) presents an inverse linear relationship between the two variables under consideration. The effect of executive compensation on earnings management is statistically significant ($P = 0.000 < 0.05$) at 5% level of significance (Table 04). The hypothesis that there is no significant effect of the executive compensation on earnings management is therefore rejected.

Discussion of Findings

This paper was conducted to examine the relationship between earnings management and quality of corporate governance in Nigeria. The outcomes of the data analysis are discussed below:

Corporate Governance Quality and Earnings Management

The result of the present study indicates a significant negative relationship between quality of corporate governance and earnings management. This result meets our priori expectations and is consistent with previous studies by Abbad, Hijazi and Al-rahahleh (2016), Beasley (1996), Klein (2002), McMullen (1996), Egbunike, Ezelibe and Aroh (2015) and Bistрова and Lace (2012). The implication is that companies with good corporate governance quality as exemplified by the implementation of codes of corporate governance mechanism tend to present more credible financial reports. The explanation also means that companies with weak corporate governance structure do not have the wherewithal to control for earnings smoothing.

Audit Committee Strength and Earnings Management

Audit committee strength is also found to be statistically significant at 5% levels and is negatively associated with earnings management practices. The result conforms to apriori expectation and consistent with prior studies (Bedard, Chtourou & Courtead, 2004; Agrawal & Chadha, 2005; Liu, Harris & Omar, 2013; Omoye & Eriki, 2014; Egbunike, Ezelibe & Aroh, 2015). The result however, does not conform to findings by Ghosh, Marra and Moon (2010). The implication of the finding is that manufacturing companies listed in the Nigeria Stock Exchange with active and independent audit committee are less likely to be subjected to high earnings management. This in other word means that strength of audit committee significantly decreases the phenomenon of creative accounting or window dressing practices.

Executive Compensation and Earnings Management

The study finds a negative and significant relationship between executive directors' remuneration and the level of discretionary accruals. The result is consistent with Chu and Song (2012), Shehu (2011), Ben- Hassen (2014), Sun and Hovey (2012) and Brown and Lim (2012). This means that when the amount of compensations granted to executives is high, discretionary accruals tend to be minimal. This position supports the theoretical assumption of aligning the interest of the executives with that of shareholders to reduce agency problems

and ensure convergence of interests. In effect, with a higher executive remuneration, the directors would be less opportunistic, reducing the tendency to manipulate the company's financial results. Chen and Li (2011) however found a positive relationship between executive incentives and earnings smoothing.

Conclusion and Recommendations

This study was carried out to examine the relationship between earnings management and quality of corporate governance in Nigeria. The study using data from annual reports of manufacturing companies for the period 2012 to 2016 analyzed some simple descriptive and correlation statistics and used regressions and econometrical approaches, to examine the relationship between the variables highlighted in the study.

The study showed that quality of corporate governance, audit committee strength and executive compensation have a significant negative relationship with earnings management in Nigeria's manufacturing companies during the period under investigation. The study therefore concludes that good corporate governance practice has a significant effect in reducing earnings manipulations which by extension improves on quality of financial reporting. Following from the findings of this study, it is recommended that stakeholders including the investing public should critically analyze corporate governance information in the financial statements to guard against negative earnings surprises. Further, audit committees should be strengthened by emphasizing independence and regular meetings of audit committee members.

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