EFFECT OF 2011 CORPORATE GOVERNANCE REFORM ON EARNINGS QUALITY: THE NIGERIAN LISTED COMPANIES IN PERSPECTIVE

BY

Imagbe, Victor Usunobun (Ph.D, FCNA, FCT1): University of Benin, Benin City, Edo State, Nigeria.

Eichie Dominic Ejiakhian (Ph.D, FCA): University of Benin, Benin City, Edo State, Nigeria

Okoughenu, Sunday Azeita (Ph.D, CNA): Department of Accounting and Finance, Faculty of Management Sciences, Ajayi Crowther University, Oyo, Oyo State, Nigeria.

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Adedipe, Oluwaseyi Ayodele (Ph.D):Department of Accounting and Finance, Faculty of Management Sciences, Ajayi Crowther University, Oyo, Oyo State, Nigeria;

***Corresponding Email: azetasunny@gmail.com; 08066918945.**

Abstract

This study examines the 2011 corporate governance reform effect on earnings quality of companies listed on the Nigerian Stock Exchange (NSE). The study covered a total population of one hundred and sixty-nine (169) companies listed as at 31st December, 2018. A sample of one hundred and nineteen (119) listed companies between 2003 and 2018 was scientifically selected and the data for the periods was obtained from the companies' annual reports and accounts. Ordinary least square regression analysis techniques were used to analyse the data by the study and the result of the random effect model revealed that the effect of 2011 corporate governance reform (proxied by DCGR) on earnings quality (proxied by DA) of companies listed on NSE was negative and insignificant. The result of the control variables shows that board size exerts negative and insignificant effect on DA, while external audit quality and firm size and had positive and insignificant effect on DA. The study concludes that the 2011 corporate governance reform in companies listed on the NSE is a welcome development because it had a positive and insignificant effect on discretionary accrual, thus increases earnings quality. The study recommends to the Nigerian regulatory bodies such as the Securities and Exchange Commission (SEC) and Financial Reporting Council of Nigeria (FRCN) to continue reforming corporate governance to strengthen the effectiveness of the corporate governance mechanisms because it will lower discretionary accrual thus increase the companies' earnings quality in Nigerian listed companies.

Keywords: 2011 Corporate governance,Reform, Earnings quality, Nigerian listed companies and Stakeholders' Theory

Introduction

Earnings quality has gained huge research attention due to its importance to the investors and other stakeholders for decision-making. In corporate organisation, earnings are essential area of consideration because it signals to the stakeholders on the financial performance during the period. The net profit of a company's operations after corporate tax and interest has been deducted from the gross profit represents the earnings of the company during the period. Earnings can be used by the users for different reasons. For instance, the financial analysts can use the current earnings to predict future cash flow of the corporate organization. The will enable the investors to make decision on whether to continue their investment or withdraw their investment to other companies that reported higher quality earnings. Earnings quality is considered to be high if it can predict the future financial performance of the firm, thus has value relevance to investors investment decisions (Ibrahim, 2017).

Given the relevance of the quality of earning reporting in the financial statements, users are interested for full disclosure of information on how every activities during the period has affected the earnings. In addition, investors appraise the performance of the corporate manager based on the quality of earnings reported during the financial period. Consequently, managers engage in various activities such as the use of discretion and accrual to manipulate earnings in the financial reports to signal better financial performance during the period (Nyabuti, Memba, & Chenge, 2016). The practice of earnings manipulation according to Imagbe and Okoughenu (2020) may have effect on shareholders' returns during the period. To protect the investors from being deceived from earnings manipulations by optimistic managers, reforms of corporate governance practice in became necessary to strengthen earnings quality. Consequently, since the year 2003 when Nigeria introduced code of corporate governance best practice in 2003 by SEC and first reformed took place in 2011 and this was basically done to improve earnings quality (Marshall, 2015). However, to the best knowledge of the researchers, evidence of empirical studies yet to be indicated in the extant literature on the effect of 2011 corporate governance reform on earnings quality in Nigerian listed companies.

Purpose of the Study

Based on the foregoing, 2011 corporate governance reform effect on earnings quality in Nigerian listed companies formed the purpose of this study.

Research Question

The question this study attempt to address is; what is the effect of 2011 corporate governance (CG) reform on earnings quality (EQ) in Nigerian listed companies?

Hypothesis

To address this question, the following null hypothesis was formulated for the study:

$H0_1$: The effect of 2011 corporate governance reform on earnings quality in Nigerian listed companies is not significant.

Literature Review

According to Marshall (2015), after the first CG in Nigeria was the introduction of code of CG best practice in 2003 by SEC followed by the introduction of 2006 post-consolidation issued by Central Bank of Nigeria to regulate the banking operations in Nigeria. In 2008, the code of CG for licensed pension operators to regulate pension scheme administration in Nigerian public and private establishment, 2009 code of good CG for insurance industry issued by the to regulate the operation of insurance companies in Nigeria, and 2011 code of CG for publicly listed companies issued by SEC and amendment in 2014. The need for reform in corporate governance according to Kostiantyn (2017) is to help improve companies' earnings quality.

Earnings quality (EQ), according to Nokashti and Vakilifard (2015), earnings are the net benefits of a firm's operations and the amount on which government charge corporate tax. Earnings can be low or high in quality depending on the behaviour of the entity reporting. Earnings are high in quality if it timely and precisely reflects the firms fundamental earning, thus, it can predict timely and accurately the shocks in the present value of expected future dividends. The common signal for high quality earning includes minimum deviation of earning numbers from actual cash-flows, to avoidance of deviation from industry and peer benchmarks, low accruals and long-term estimates, total correspondence of analyst forecast, consistent applications of accounting policies and methods and strong corporate governance mechanisms (Ogadu, Okoughenu & Igbeneweka, 2017). In addition, Lo (2007) stated that earnings quality and earning management are interrelated concept which means that low earning management is a signal of high earnings quality, otherwise, low earnings quality.

Theoretically, there are many theories related to corporate governance and earnings quality which include agency theory, signal theory, stakeholders' theory, and informatory asymmetric theory. However, since all stakeholders must be affected by the reported earnings of the company, this study anchored on the stakeholders' theoretical assumption. Stakeholders' theory was developed by Freeman in 1984 and the theory assumed that since there are different stakeholders to the company, the directors should be in a position of trust to manage the company in a way that long-term sustainable value will be created. In the same way, Adegbie, Akintoye, and Isiaka, (2019) stated that stakeholders' theory argued that directors must ensure that they provide information that satisfies not only the owners (shareholders) but to all other interest groups within the stakeholder context. Therefore, the stakeholders' theory predicts positive effect of CG on EQ.

Empirically, many studies have been indicated in extant literature particularly CG effect on EQ both in Nigeria and other countries. For instance, earning quality was examined by Adegbie, et al. (2019) and the study specifically find out how it has been affected by corporate governance of a sample of thirty (30) quoted financial and non-financial firms in Nigeria from 2003 to 2017. Multiple regression analyses were employed by the study to test the hypotheses and the result showed that the effect of size of the board on EQ was significant and positive. However, the size of board and earnings management was revealed by Kuma, Abraham, and Terpase (2019) to be positive insignificant. The study used some aspects of CG mechanisms to examine earnings management in oil and gas and Information technology communication sectors in Nigeria from 2013 to 2017. Similarly, the study of Ibrahim and Jehu (2018) used a sample of five hundred and seventy-six (576) in Nigerian firms from 2011 to 2016 to reveal insignificant relationship between board size and financial reporting quality.

A total observation of two hundred and fifty-five (255) companies in Thailand were used by Yodbutr (2017) to assessed how CG related with earnings management from 2011 to 2015. The data were analysed with multiple regression statistical approach and the result showed that board size was not positively associated with earnings quality. Also, In Kenya, the association between corporate governance and earnings management was analysed by Chelogoi (2017) and the study covered a sample of forty-five (45) listed firms at Nairobi securities exchange from 2005 to 2012. The data the study obtained through secondary sources were analysed with regression approach and the result showed that managerial ownership was significantly and positively related to EQ. The extent ownership and regulation affects bank earnings were assessed in the Middle East and North Africa by Bourkhis and Najar (2017) with a sample of one hundred and fifty-eight (158) banks comprising. The study indicated higher EQ for listed and widely held banks, but lower EQ for state-owned banks. In addition, the study found that in the Islamic banks, there was a significant high of earnings than the conventional banks, thus suggesting that earnings quality was improved as a result of tighter supervision of the banks through regulation.

Methodology

Ex-post facto research design is adopted by the study to examine the 2011 CG reform effect on EQ of Nigerian listed companies. The study obtained data through secondary sources and one hundred and sixty-nine (169) companies listed on the NSE as at 31st December, 2018 formed the population of this study. In addition, the firm in the population had annual reports and accounts for sixteen consecutive years for the period between 2003 and 2018 (i.e., 2003 to 2010 for pre-2011 corporate governance reform and 2011 to 2018 is post-2011 corporate governance reform). The study adopted Yemane (1967)'s formula to arrive at a samples size of one hundred and nineteen (119) companies listed on the NSE. Since the study aimed to the effect and data are collected across firms over time (panel data) ordinary least square regression approach is employed to analyse data.

The study adopted the Modified Jones model provided by Dechow, Sloan, and Sweeney (1995) and the model is regressed as followed:

$$DA_{it}=\beta_0+\beta_1 DCGR_{it}+\beta_2 BS_{it}+\beta_3 EAQ_{it}+\beta_4 FS_{it}+e_{it} \quad \ldots\ldots 3.1$$

Where; *DA* is discretionary accruals and measured by total accruals less non-discretionary accruals on the assumption that lower DA signal higher earnings quality, *DCGR* is 2011 corporate governance reform and measured as dummy variable (i.e., "1' for post-2011 corporate governance reform and '0' for pre-2011 corporate governance reform). The control variables are *BS* which is size of the board and total number of board members used to measured it by the study, *EAQ* is external audit quality and measured as dummy which equal to "1" if a company used either of KPMG, Delloitte, Ernst & Young, and PriceWaterHouse Cooper or otherwise "0" and *FS* is the size of the company and the natural logarithm of total assets is used by the study to measure it. β_0 is intercept for the model, β_1 –β_4 is coefficients of the independent variables, *eit* is disturbance terms that absorbs effect from other variables that are not used in the study.

Results

Table 1 Pooled Ordinary Regression

Dependent Variable: DA
Method: Panel Least Squares
Date: 1/2/21 Time: 13:10
Sample: 2003 2018
Periods included: 16
Cross-sections included: 119
Total panel (unbalanced) observations: 1904

Variable	Coeff.	Std. Error	t-Statistic	Prob.
EAQ	0.010824	0.050313	0.215135	0.4291
FS	0.012744	0.009829	1.296567	0.1949
BS	-0.026745	0.010406	-2.777183	0.0330
DCGR	-0.018179	0.046878	-0.387799	0.6982
C	-0.596273	0.189365	-3.148803	0.0017

R-squared	0.013999	Mean dependent var	0.055574
Adjusted R-squared	0.009834	S.D. dependent var	1.017149
S.E. of regression	1.012136	Akaike info criterion	2.866721
Sum squared resid	1940.249	Schwarz criterion	2.892974
Log likelihood	-2718.685	Hannan-Quinn criter.	2.876385
F-statistic	3.361225	Durbin-Watson stat	1.531836
Prob(F-statistic)	0.000783		

Table 1 presents the pool regression results on the effect of 2011 CG reform (proxied by DCGR) on earnings quality (proxied by DA). The result showed a coefficient value of -0.018179 and probability value of 0.6982 (70%) greater than 0.05 (5%), thus suggesting that the effect of DCGR on DA is not significant. In addition, the result suggests that the 2011 corporate governance reform tend to exhibit lower discretionary accrual thus, higher earnings quality of the sampled companies. Furthermore, the control variables, EAQ and FS exert positive and insignificant effect on DA with coefficient value of 0.010824 and 0.012744 and probability value of 0.4291 (i.e., 43% less than 5%) and 0.1949 (i.e., 20% less than 5%) respectively, thus suggesting higher discretionary accrual and lower earnings quality of the sampled companies. But BS exert negative and significant effect on DA with coefficient value of -0.026745 and probability value of 0.0330 (3%) less than (5%), implying that increase in these variables would lead to a significant decrease in discretionary accrual, thus increase earnings quality significantly of the sampled companies.

The R-square showed 0.013999 suggesting that 99% of the systematic variation in dependent variable (i.e., DA) cannot be explained by other variables on the assumption that the study did not considered heterogeneity effect across firms sampled. The F-statistics value is 3.361225 with a probability value of 0.000783 suggesting a significant linear relationship existed between the dependent and explanatory variables. Durbin-Watson statistic showed 1.531836 which is very close to 2.00 suggesting absence of problem of multicollinearity in the regression model and according to Mundfrom, Smith, and Kay (2018), this result implies that the model is fit in the study.

Table 2 Fixed Effects Regression (FER)

Dependent Variable: DA
Method: Panel Least Squares
Date: 1/2/21 Time: 13:10
Sample: 2003 2018
Periods included: 16
Cross-sections included: 119
Total panel (unbalanced) observations: 1904

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EAQ	0.019545	0.089531	0.218301	0.8272
FS	0.039498	0.033225	1.188811	0.2347
BS	-0.027533	0.021231	-1.335870	0.4994
DCGR	-0.042226	0.040252	-1.049033	0.2943
C	-0.903657	0.291765	-3.097206	0.0020

R-squared	0.431702	Mean dependent var	0.055574
Adjusted R-squared	0.291785	S.D. dependent var	1.017149
S.E. of regression	0.855987	Akaike info criterion	2.591282
Sum squared resid	1301.300	Schwarz criterion	2.961750
Log likelihood	-2338.605	Hannan-Quinn criter.	2.727653
F-statistic	7.219259	Durbin-Watson stat	1.942502
Prob(F-statistic)	0.000237		

Table 2 presents the FER results on the effect of 2011 CG reform (proxied by DCGR) on earnings quality (proxied by DA). The result showed a coefficient value of -0.042226 and probability value of 0.2943 (30%) greater than 0.05 (5%) suggesting that the effect of DCGR on DA is not significant. In addition, the result suggests that the 2011 corporate governance reform tend to exhibit lower earnings discretionary accrual, thus higher earnings quality of the sampled companies. Furthermore, the control variables, EAQ and FS exert positive and insignificant effect on DA with coefficient value of 0.019545 and 0.039498 and probability value of 0.8272 (i.e., 83% less than 5%) and 0.2347 (i.e., 24% less than 5%) respectively, thus implying that increase in these variables would lead to increase in discretionary accrual and reduces earnings quality of the sampled companies. But BS exert negative and insignificant effect on DA with coefficient value of -0.027533 and probability value of 0.4994, implying that increase in these variables would lead to decrease in discretionary accrual, thus increase earnings quality of the sampled companies.

The R-square for the showed 0.431702, thus suggesting that 57% of the systematic variation in dependent variable (i.e., DA) cannot be explained by other variables on the assumption that the study did not considered heterogeneity effect across firms sampled. The F-statistics value is 7.219259 with a probability value of 0.000237 suggesting a significant linear relationship existed between the dependent and explanatory variables. Durbin-Watson statistic showed 1.942502 which is very close to 2.00 suggesting absence of problem of multicollinearity in the regression model and according to Mundfrom, Smith, and Kay (2018), this result implies that the model is fit in the study.

Table 3 Random Effects Regression (RER)

Dependent Variable: DA
Method: Panel EGLS (Cross-section random effects)
Date: 11/26/21 Time: 23:28
Sample: 2003 2018
Periods included: 16
Cross-sections included: 119
Total panel (unbalanced) observations: 1903

Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EAQ	0.038097	0.073541	0.518033	0.6045
FS	0.023014	0.018665	1.232982	0.2177
BS	- 0.03865	0.014198	-2.710944	0.6461
DCGR	-0.032630	0.039996	-0.315837	0.3817
C	-0.774096	0.229989	-3.365791	0.0008

Weighted Statistics

R-squared	0.543000	Mean dependent var	0.020144
Adjusted R-squared	0.239151	S.D. dependent var	0.861042
S.E. of regression	0.857094	Sum squared resid	1391.350
F-statistic	5.295804	Durbin-Watson stat	2.015901
Prob(F-statistic)	0.000011		

Table 3 presents the RER results on the effect of 2011 CG reform (proxied by DCGR) on earnings quality (proxied by DA). The result showed a coefficient value of -0.032630 and probability value of 0.3817 (38%) greater than 0.05 (5%), thus suggesting that the effect of DCGR on DA is not significant. In addition, the result suggests that the 2011 corporate governance reform tend to exhibit lower discretionary accrual, thus higher earnings quality of the sampled companies. Furthermore, the control variables, EAQ and FS exert positive and insignificant effect on DA with coefficient value of 0.038097 and 0.023014 and probability value of 0.6045 and 0.2177 respectively, implying that increase in these variables would lead to increase in discretionary accrual, thus reduce earnings quality of the sampled companies. But BS exert negative and insignificant effect on DA with coefficient value of -0.03865 and probability value of 0.6461, implying that increase in these variables would lead to decrease in discretionary accrual, thus increase earnings quality of the sampled companies.

The R-square showed 0.543000 suggesting that 46% of the systematic variation in dependent variable (i.e., DA) cannot be explained by other variables on the assumption that the study did not considered heterogeneity effect across firms sampled. The F-statistics value is 5.295804 with a probability value of 0.000011 suggesting a significant linear relationship existed between the dependent and explanatory variables. Durbin-Watson statistic showed 2.015901 which very close to 2.00 and according to Mundfrom, Smith, and Kay (2018), this suggests absence of problem of multicollinearity in the regression model and fit in the study.

Table 4 Hausman Test (HT)
Equation: EQ01
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	5.932214	4	0.1151

Table 4 is the HT to examine the appropriateness of either the FEM or the REM for the study's regression analysis. The HT result showed a probability value of 0.1151 greater than 0.05, thus suggesting that the random effect model interpreted the result of the analysis in the study appropriately.

Discussion of Findings
Based on the result of REM, the result showed a coefficient value of -0.032630, t-statistic value of -0.315837 and probability value of 0.3817 (38%) greater than 0.05 (5%), thus suggesting that the effect of 2011 corporate governance reform (proxied by DCGR) and measured by dummy variable on discretionary accrual (proxied by DA) is not significant, thus the study rejects the null hypothesis formulated. In addition, the result suggests that the 2011 corporate governance reform tend to exhibit lower discretionary accrual, thus higher earnings quality. However, this result is consistent with stakeholders' theory which suggests that, reform in corporate governance would reduce the extent of earnings management practices, thereby placing the firms' earnings quality to be high that will enables the stakeholders to make positive decision. Furthermore, the result agreed with the finding indicated by Bourkhis and Najar (2017) who suggested that earnings quality improved as a result of tighter supervision of the banks through regulation.

Conclusion
The study examined the 2011 CG reform effect on EQ in Nigerian listed companies. The study proxied the dependent variable which is earnings quality by discretionary accrual based on the assumption that lower discretionary accrual signals higher earnings quality of the sampled companies. The independent variable which is 2011 corporate governance reform was proxied by dummy variable (DCGR) in the study. Based on the findings from the regression analyses by random effect model, the study concludes that the 2011 corporate governance reform in companies listed on the NSE is a welcome development because it had a positive and insignificant effect on discretionary accrual, thus increases earnings quality.

Recommendation
The study recommends to the Nigerian regulatory bodies such as SEC and FRCN to continue reforming the corporate governance to strengthen the effectiveness of the corporate governance mechanisms because it will not only reduce the discretionary accrual but increase EQ in Nigerian listed companies.

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