Effect of Corporate Disclosure on Earnings Management of Listed Conglomerates Firms Nigeria

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Abstract

The aim of this study is to examine the influence of corporate disclosure on earnings management of listed Conglomerates in Nigeria. The secondary sources of data were employed while the panel data collected was analysed using multiple regression model. The findings revealed that the explanatory variables have significant impact on earnings management of listed Conglomerates in Nigeria. The study recommends that the Conglomerates may increase their leverage levels, which apart from enjoying the benefits of debt financing such as tax shield, provides an incentive to corporate disclosure quality, among others.

Keywords: Corporate Disclosure, Earnings Management, Conglomerate Firms, Tax Shield

1. INTRODUCTION

The quest for producing quality financial report has become a global phenomenon. The global financial crises of the 1930s, 2008, and the recent one in 2015 to 2016 necessitated the demand form unbiased financial reporting, with the accounting figures not just free of error, but also a true reflection of an organization's activities for the period being reported. Shehu and Farouk (2014) observe that due to the financial crises, accounting earnings reported by corporations may be far from being relevant, reliable and effective. Regulators and other stakeholders place a very high premium on the veracity of financial report. The truthfulness of the report depends on the reliability of reported earnings. This desired need could make management to become subjective in the way it recognizes, measure and allocate values to certain items of expenditure and revenues in the financial report.
Pattaraporn (2016) observed that investors give more attention to earnings in the financial reports more than other accounting information; therefore, management becomes prone to influencing accounting earnings in order to meet investors' expectations. According to Shehu (2013)due to income smoothening activities, management can manipulate certain items in thefinancials to achieve a desired result. Manipulation of earnings impairs on the quality offinancial reports and diminishes investors' confidence (Shehu & Abubakar, 2012). Therefore, the motivation to examine the factors that could minimize or eliminate earnings management through disclosure quality,

Earnings management is a fundamental aspect of financial reporting quality. How earnings are recognized and measured is essential to the quality of financial reporting. Corporations, through their managers are duty bound to report business activities for the benefit of shareholders, potential investors, regulators/policy makers, suppliers of finance and other stakeholders. This is usually done through the production of annual reports covering their economic, financial, environmental and social activities. These reports are expected to be high quality information, portraying a true and fair view of transactions (Kibiya, Ahmad, & Amran, 2016). However, the practice of earnings management flaws this process of producing quality financial reports and questions the credibility of the quality of reported earnings (Shehu & Abubakar, 2012). Several studies have been conducted on the quality of reported earnings in relation to specific firm characteristics of corporations in Nigeria. The outcomes of these studies have documented varying and conflicting results, thereby pointing to the inconclusiveness of the subject matter. Besides, though some studies have been carried out in the non-financial sector of the Nigerian economy, to the best of the researchers' knowledge, little or no study have been done in the Conglomerates sector in regards to this study. The choice of studying the Conglomerates sector is hinged on the fact that little or nothing has been said about the disclosure quality of the sector so as to determine the degree to which the managers of these Conglomerates have being able to give account of their stewardship by minimizing or eliminating cooked records from their financial report.On this basis, it is therefore important and equally necessary to identify the factors of disclosure quality that could impact on earnings management. Thus, the broad objective of this study is to examine

the influence of corporate disclosure quality earnings management of listed conglomerates in Nigeria. Also, the study will attempt to test the validity or otherwise of the following hypotheses all stated in null form.

H_{O1}: Age of a firm has no significant effect on earnings management of listed Conglomerates in Nigeria.

H_{O2}: Leverage of a firm has no significant impact on earnings management of listed Conglomerates in Nigeria.

H_{O3}: Liquidity of a firm has no significant influence on earnings management of listed Conglomerates in Nigeria.

2. LITERATURE REVIEW

2.1 Conceptual Framework

2.1.1 Concept of Disclosure Quality

Smith (2014) defined disclosure and transparency in corporate governance as availing the truth to every stakeholder. Smith adds that by definition if a company is only to let the truth be known that presupposes a passive position on matter disclosure. He opines that the current corporate governance mechanism calls for active disclosure transparency of company's information bringing in a whole new meaning to a firm, as transparent actions put new responsibilities to a firm. According to Organisation for Economic Co-operation and Development (OECD) (2012), an appropriate governance framework should ensure timely and accurate disclosure of all material matters, including financial situation, performance, ownership and governance of a company at least once a year, or twice a year, or quarterly, and if possible every month. The quest for material development according to OECD is that users are bound to take up information that is omission or misstatement which could negatively influence economic decisions. The OECD also stipulates that firms should simultaneously disclose information to all shareholders without creating unreasonable administration or cost burdens. Further, according to Solomon and Solomon (2004) transparency in corporate governance is an important element of a well-functioning system. Disclosure therefore involves information emanating from the firm and ranges from financial statements; the profit and loss account, cash flow statement and balance sheet to other mandatory reports like AGM and management forecast (Healy & Palepu, 2001).

Indeed, studies on disclosure and corporate performance of firms have yielded various results. Bhagat and Bolton (2008), for instance, studied the importance of disclosure in preventing financial fraud in the money market, and established that when self-interest behaviour veers into criminality, true transparency may cast light on financial malpractice activities that could lead to a change in behaviour. The study further observed that increased transparency is important to the future success of corporate governance. The study underscored that transparent disclosure is the only practice that is likely to deter fraud, embezzlement and financial scandals – the necessary conduct that can enhance the fostering of efficiency in allocation of investments across companies and regions. The study concluded that rules, regulations, laws, concepts, structures, processes, best practices and most progressive use of technology cannot ensure transparency and accountability, which can only come about when individuals of integrity do the right thing. A study by Patel, Balic, and Bwakira (2002) found that when a firm embraces higher transparency and disclosure, the information asymmetry is considerably reduced. The findings suggested that firms with higher levels of disclosure and transparency are more valued than firms with lower disclosure and transparency; meaning that improved disclosure and transparency implies strong corporate governance practices leading to better firm performance. Chiang and Chia (2005) established that transparency and disclosure has a significant positive relationship with corporate performance and termed it as the most important indicator for measuring firm performance. On the same line, Fan and Wong (2005) argue that disclosure of material information like related-party transactions, external audit results and insider transaction are a priority in corporate governance. Lewis and Mallat (2009) observe that disclosure and transparency in stock markets play crucial roles in corporate governance, allowing organizations to publish data on key management practices, such as financial and non-financial statements, corporate social responsibility (CSR) activities and audit reports. They add that, such an approach enable shareholders become aware of issues affecting their investments. This constitutes an important aspect of shareholder theory, that the directors of the company should manage it on behalf of the shareholders.

According to Epstein and Buhovoc (2006), shareholders need all information about the capital they have invested in a company that is managed by corporate directors in order to ascertain that their interests are being taken care of.

Shareholders need also be familiar with procedures and strategies that have been put in place to reduce costs in the event of failure of management to perform its duties. Often times, disclosures have revealed faults within companies and conflicts of interests between management and shareholders. Finally, information disclosure is a key factor in the determination of the value of a company, the trading of its shares in the stock market, and the appointment and exemption of directors (Epstein & Buhovoc, 2006).

2.1.2 Concept of Earnings Management

One of the most influential factors that can use to measure financial reporting quality is earnings management transparency (Patel, Balic, & Bwakira, 2002). Managers use earnings management base on financial reporting viewpoint to avoid reporting losses from the companies' financial transactions or to meet analysts' forecasts, thereby hoping to avoid damage reputation and strong negative share price reaction that will lead to a failure to meet company investors' expectations. When managers' are more concerned about share price effects and requiring greater reporting transparency, they should reduce value of earnings management to improve transparency (Hunton, Libby, & Mazza, 2006). Theories suggest that detection of earnings management is easier resulting from improved transparency which should reduce the expected value of earnings management.

Earnings management occurs as a result when managers' use personal judgement in financial statement and in structuring transactions to alter financial reports to either deceive some stakeholders about the fundamental economic performance of the company or to influence contractual outcomes that depend on the reported accounting figures. Earnings management involves potential wrongdoing, mischief, conflict, and a sense of mystery. Managers are less likely to manage earnings if they have professional designations and subscribe to codes of ethical conduct. Earnings management can be classified into two different categories: The real earnings management that is affecting cash flows and accruals management through accounting policies and changes in estimates. The real earnings are costly to the company and mangers are keen to engage, hence such actions are harder to detect (Lo, 2008). This is consistent with the study on accrual-based and real earnings management activities around equity offerings adopted by Cohen and Zarowin (2010). They study suggested that managers prefer real earnings management compared to accrual-based because managers are less likely to be scrutinized by auditors, regulators, and thus have likely to greater probability of not been detected. However, when managers engage in real earnings management, three possible manipulation methods occurred; acceleration of the timing of sales through increased price discounts, reporting of lower cost of goods sold through increased production, and decreases in discretionary expenses including advertising and R&D expenses.

Marai and Pavlovic (2013) reported that earnings management practices through accounting accruals usually result financial fraud which involve using estimates or judgments allowed by managers, such as expected lives and rescuing values of long-term assets, obligations for pension benefits and other post-employment benefits. The study by Tandeloo and Vanstrelen (2011) viewed earnings management as a way of assessing the quality of reported earnings by examining to what extent earnings are managed, with the intention to either mislead some stakeholders about the underlying economic performance of the company. The study reported that managers were significantly encouraged to engage in earnings smoothing after the adoption of IFRS especially if company does not have a Big 4 auditor. Managing earnings is "a purposeful intervention in the external financial reporting process, with the intent to obtaining some private gain as opposed to say, simply facilitating the neutral operation of the process (Schipper, 1989; cited in Beneish, 2001). Therefore, if managers allowed too much earnings management in the company's financial transaction will lead investors to make poor investment decisions, hence financial reports is of no quality.

2.2 Empirical Framework

In the study conducted by Huang, Ena, and Lee (2012) and Chalaki, Didar, and Riahnezhad (2012) found that age is not statistically significant with financial reporting quality. Hossain (2008)also reported insignificant relationship. The result of the study of non-financials firms inNigeria by Kibiya, et al. (2016) found a significant association between age and financial reporting quality. Akhtaruddin, Hossain, Hossain, and Yao (2009), Agyei-Mensah (2012), Fathi, (2013), Uwuigbe, Uwuigbe, and Okorie (2015), Olowokure, Tanko, and Nyor (2016), did

not find anystatistical relationship between leverage and disclosure quality. On the contrary, the regression result of the work of Shehu (2013), Shehu and Farouk (2014), Karami and Akhgar (2014), Kim and Yang (2014), and Amr (2016), found positive significant relationship between firm leverage and financial reportingquality. Marginally positive impact of the IFRS adoption on disclosure has been found by Bokpin (2013) in his study on the capital market of Ghana. According to this study, firm size, financial leverage, age of the company, its profitability and the audit quality have been found to be significant firm level characteristics determining corporate disclosure.Shehu and Ahmad (2013), Shehata, Dahawy, and Ismail (2014) however reported a negative significant relationship. Aljifri, Alzarouni, Ng, and Tahir (2014) found aninsignificant relationship in their study.

Mendes-Da-Silva and Onusic (2014) analyse the link between certain firm characteristics and the web-based disclosure which is taking prevalence over other methods of disclosing data and changing the entire disclosure ambiance. Although the size of the company and the acceptance of best corporate governance practices have proven their expected positive impact on transparency, somewhat surprising outcome has been the negative impact of the length of the period of company listing on the stock exchange. In a more recent study, Ahmed (2015) explores the determinants of the quality of disclosed earnings in ten European transition economies. He finds significant cross-country differences of the relevant factors, where the ownership structure plays important role in determining the quality of disclosure in most transparent countries, while financial factors are a more significant determinant in the countries with poorer disclosure practices.The findings of Amr (2016), Shehu andFarouk (2014) revealed a positive significant relationship between liquidity and financial reporting quality. Aksu and Espahbodi (2016) investigate the behaviour of the companies listed on the Istanbul Stock Exchange to determine if mandatory or voluntary regulation provides better results in terms of disclosure quality. They find out that the mandatory implementation of International Financial Reporting Standards (IFRS) have had positive impact on the transparency disclosure practices of the Turkish firms.

2.3 Theoretical Framework

2.3.1 Agency Theory

Agency theory serves as the foundation for this study. The agency theory defines the principal-agent relationship. The principal here are shareholders while agents refer to the managers. These parties have divergent interests, thus giving rise to agency costs, Shehata (2014).Disclosures by way of financial reporting and regulation help to mitigate the agency problem as it requires that management of corporations report both mandatory and voluntary information for the benefit of shareholders and other interest parties. By and large, since managers have first-hand information about operations of a business, they are duty bound by the agency theory to report as appropriate to the owners of the businesses. Disclosure of financial information lessens agency costs and also makes it easy for creditors to evaluate the volatility of a company, and likely ask more information to safeguard their resources (Botosan & Plumlee, 2002; Fathi, 2013; Echobu, Okika, & Mailafia, 2017).

3. METHODOLOGY

In selecting the choice of research method to be used by a researcher for the purpose of acquisition, analysis and interpretation of data, it is very paramount to put in mind the nature of the study, the problem at hand and the desired objective. In line with this, Ex-post facto design was adopted for the study. The population of this study is made up of the six (6) Conglomerates listed on the Nigerian Stock Exchange (NSE) in Nigeria as at 18th December, 2019 (Nigerian Stock Exchange, 2019). The listed Conglomerates are A.G. Leventis Nigeria Plc.; Chellarams Plc.; John Holt Plc.; SCOA Nigeria Plc.; Transnational Corporation of Nigeria; and UACN Plc. However, from the study population, the sample size of the study is made up of five (5) Conglomerates, which are A.G. Leventis Nigeria Plc.; Chellarams Plc.; John Holt Plc.; SCOA Nigeria Plc.; and Transnational Corporation of Nigeria; using a filtering system to eliminate UACN Plc. This filtering system is that a conglomerate should have data available within the period of the study. Secondary sources of data were employed. This secondary data were sourced from annual reports and accounts of the selected listed Conglomerates.

The multiple regression analysis using Ordinary Least square (OLS) was employed to test the influence of corporate disclosure quality on listed Conglomerates in Nigeria. The model specified below follow the model

specification of Echobu, Okika & Mailafia (2016) and modified to examine the influence of corporate disclosure quality on listed Conglomerates in Nigeria.

$E_M = \beta_0 + \beta_1 Age + \beta_2 Lev + \beta_3 Liq + Er$

Where E_M= Earnings management; Age= Age of the firm; and Lev = Leverage of the firm; while β_0, β_1, β_2, β_3 are the coefficient of the variables.

The measurement of variables as shown in the model specification are shown table 3.1

Table 3.1: Variable Definition

Variables	Acronym	Measurement	Validity
Dependent			
Earnings Management	E_M	Total accrual / Total assets, where total accrual equals earnings before extraordinary items less cash flow from operating activities	Modified Jones model (1991); Dechow, Sloan, and Sweeneyl (1995) as in Bala and Kumai (2015)
Independent			
Age	Age	Date of incorporation	Olowkure, Tanko, and Nyor (2016)
Leverage	Lev	Total debt / Total equity	Botosan and Plumlee (2002); Fathi (2013)
Liquidity	Liq	Current assets / Current liabilities	Shehu and Ahmad (2013); Shahata, et. al. (2014); Aur (2016)

Multiple regression analysis was used because it tries to forecast a normal or scale dependent variable from a combination of several scale and/or dichotomous independent/predictor variables. Statistical Package for the Social Sciences (SPSS) was used to analyze the data. The researcher used the Ordinary Least Square (OLS) method. Ajani (2012), states that the Ordinary Least Square (OLS) is a multiple regression analysis method where it is assumed that all of the predictor variables are important. Multiple regressions using Ordinary Least Square (OLS) allows the researcher to consider all the variables at the same time.

4. RESULT AND DISCUSSION

The data employed for the analysis of the regression results are shown as follows. This section analyses and interprets the outcomes gotten from the tests conducted on the data collected for the study. This is followed by drawing relevant inferences from the analysis as well as the test of hypotheses formulated for the study.

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.730[a]	.534	.467	.11257

a. Predictors: (Constant), LIQ, LNAge, LEV

Sources: SPSS Version 20 (2020)

Table 4.3 indicates that the R which represents the correlation coefficient shows a strong explanation of 0.730, while the more crucial variable R squared shows an output of 0.534, which signifies that changes associated with the response variable (earnings management) is captured by the changes in the explanatory variable (corporate disclosure quality).

Table 4.4: ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.

1	Regression	.304	3	.101	8.009	.001[b]
	Residual	.266	21	.013		
	Total	.571	24			

a. Dependent Variable: E_M
b. Predictors: (Constant), LIQ, LNAge, LEV
Sources: SPSS Version 20 (2020)

Table 4.4 also showsthat the Analysis of Variance table (ANOVA) showing asignificant regression at the 1% level of significance with F statistics of 8.009 showing the fitness of the model.

Table 4.5: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-.103	.155		-.665	.513		
	LNAge	-.154	.084	-.308	-1.831	.081	.783	1.277
	LEV	.035	.012	.507	2.872	.009	.714	1.401
	LIQ	.226	.054	.695	4.158	.000	.794	1.259

a. Dependent Variable: E_M
Sources: SPSS Version 20 (2020)

Table 4.5 indicates that the Tolerance value statistics are consistently greater than the common benchmark of .10 and also the Variance Inflation Factor in relation to all the variables considered are consistently less than 10. These confirm the absence of multicollinearity in between the explanatory variables.

4.1 Discussion of Findings

From table 4.3, 53.4% R squared indicates that earnings management are affected by the explanatory variables captured in the study. This could mean that about 46.6% of variables not captured in this study but serves as determinants of corporate disclosure quality could impact on earnings management, which could be in the interest of the shareholders. In addition, table 4.5 shows the regression results on the influence of corporate disclosure quality on earnings management. The estimated regression equation for the model is
E_M = -0.103 – 0.154 (LNAge) + 0.035 (LEV) + 0.226 (LIQ)

The model indicates how the results show the coefficient of determination for the model, which is fitted at 1%. This coefficient measures the proportion of the total variation in the earnings management as explained by the corporate disclosure quality, which is 53.4%. In addition, the study provides evidence that the age of the firm is significant at 10% and negatively associated with earnings management, this provides grounds to reject the null hypothesis, which states that the age of the firm has no significant effect on earnings management. The age of a firm is considered as one of the essential determinants of financial reporting quality. Thisaffirms that internal control system of a firm gets stronger with age, and a strong and well-structured internal control system guarantees corporate disclosure quality. As firms advance in age, they also improve in their governancemechanisms, and as a result, become more closely monitored by government regulatoryagencies. This is expected to produce a corresponding improved disclosure quality. This result is consistent with prior findings of Kibiya, et al. (2016). However, this result is contrary to the findings of Hossain (2008), Huang, Ena, and Lee (2012), and Chalaki, et al. (2012) as they reported insignificant relationship.

More so, a positive and significant relationship at 1% between leverage and earnings management is found in this study. This could mean that disclosure of financial information lessens agencycosts and also makes it easy for creditors to evaluate the volatility of a company, and likelyask more information to safeguard their resources. This position is consistent with the findings of Botosan and Plumlee, (2002) and Fath i(2013), Amr (2016), among others. However, this is contrary to the findings of Fathi, (2013), Uwuigbe, Uwuigbeand Okorie (2015), Olowokure, et al. (2016). Thus, serving as an evidence to reject the stated null hypothesis, this indicated otherwise.

Finally, the study provides a positive and significant association between liquidity and earnings management. This could mean that a firm with good financialperformance indices such as liquidity has more inducement to provide earningsinformation of higher quality,while firms withvery impressive liquidity are more likely to disclose information on their performance toinvestors and other stakeholders. On the other hand, firms with low liquidity may alsoreveal more information to show that management is aware of the company's positionand to avoid claims my shareholders.Thus, the null hypothesis is also rejected. This result is in tandem with the findings of Shehu and Farouk (2014), Amr (2016), and Aksu and Espahbodi (2016) among others.

5. CONCLUSION AND RECMMENDATIONS

The study concludes that the age of Conglomerates, their leverage, and liquidity have significant influence in minimizing or eliminating earnings management through quality disclosure. Following the findings of this study, the studytherefore recommends that the Conglomerates may increase their leverage levels, which apart fromenjoying the benefits of debt financing such as tax shield, provides an incentive to corporate disclosure quality. Similarly, a good liquidity position should be maintained as it has been foundnot only to preserve the going concern of the Conglomerates but also a strong feature for enhancing the quality disclosure. Finally, the NSE should review its monitoring rules to ensure definite rules for theprevention of window dressing behaviour of management in financial reporting. This willfurther boost investors' confidence in listed Conglomerates in the NSE.

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