

CORPORATE GOVERNANCE MECHANISMS AND EARNINGS MANAGEMENT OF QUOTED CONSUMERS GOODS FIRMS IN NIGERIA

¹Taiwo, J. A., ²Atanda, K. and ¹Oladeji, A. I.

¹Bursary Department, Oyo State College of Agriculture and Technology, Oyo State, ²Audit Department, Oyo State College of Agriculture and Technology, Oyo State

Correspondence email: joshuaabiodun83@gmail.com Phone number: 07034226852

Abstract

The study assessed the impact of board attributes, assurance quality and ownership structure on the earnings management of quoted consumers' goods firms in Nigeria. The study was implemented with a view to establishing the significance of corporate governance mechanisms in restraining the practices of earnings management in Nigeria. The study measured board attributes from the dimension of board independence and audit committee financial expertise, assurance quality proxied by audit tenure and audit fees while ownership structure was measured by managerial and institutional ownership with earnings management being represented by discretionary accrual. The study employed secondary source of data to extract data from published financial reports of twelve (12) quoted firms' selected using purposive sampling method for the periods of 2012 – 2021. Paneled regression technique was employed on the dataset. The result shows that only board independence recorded a significant impact ($\beta = 0.1387$; $t = 2.2236$; $p < 0.05$) on the earnings manipulation while audit committee financial expertise was not found to make significant positive impact ($\beta = 0.0462$, $t = 0.8217$, $p > 0.05$) to the earnings management of the selected firms in Nigeria. As regards audit quality, the result revealed that auditor tenure ($\beta = -0.0160$; $t = -0.7283$; $p < 0.05$) is inversely related to earnings manipulation while audit fee failed to have significant inverse impact ($\beta = -0.0008$; $t = -0.1044$; $p > 0.05$) on the explained variable of the study. In relation to ownership structure, the result shows that managerial ownership exhibits significant negative relationship ($\beta = -0.0271$; $t = -0.5763$; $p < 0.05$) with the earnings manipulation whereas institutional ownership ($\beta = 0.0219$; $t = 0.4260$; $p > 0.05$) was not found to give a significant impact on the practices of earnings management of the sampled firms in Nigeria. The study concluded that corporate governance practices adopted by the sampled firms restrain significantly opportunistic practices of profit management in Nigeria.

Keywords: Board independence; Audit fees; managerial ownership; discretionary accruals.

Introduction

Financial reports play a prominent role in demonstrating managerial stewardship as corporate managers are obligated to give their performance reports to the company's owners. The information presented in financial reports is a description of company's financial and economic state. Management's expertise and understanding of the business environment are expected to provide effective financial reports that portray a true and fair picture of the company's financial performance, allowing diverse stakeholders to make informed decisions (Susanto Pradipta and Handojo, 2021). Despite putting forth excellent financial management practices, corporate managers of publicly traded companies sometimes employ tactics of profit management to manipulate the company's reported performance.

Earnings management (or profit management) is an accounting practice that uses a variety of accounting procedures to generate financial statements which present a company's economic activities and financial status in the best possible picture (Vagner *et al.*, 2021). Owing to the separation of ownership and management, the motive for misleading reported performance is rooted in a conflict of interest between managers and shareholders (d'Udekem, 2021).

Directors are free to use their judgment in adopting reporting methods that reflect the firm's economics in order to improve financial reporting; yet, this creates opportunity for them to manipulate earnings. Managers often attempt to close the reported profits to the desired profit level by taking deliberate efforts within the scope of generally accepted accounting standards (GAAP) (Salehi *et al.*, 2020). Corporate

governance, according to Susanto *et al.* (2021), is one of the ways used to oversee companies and impose constraints on management behavior. Larkan and Tayan (2011) view corporate governance as the collection of control mechanisms that a company uses to prevent or dissuade potentially self-interested managers from engaging in activities that are harmful to the interests of shareholders and other stakeholders. Corporate governance is therefore, about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that will foster good corporate performance (Uwuigbe and Fakile, 2012).

Sequel to the high-ranking scandals that led to the implementation of the Saban-Oxley Act 2002 in the United States, Nigeria's corporate governance history followed that of the United States. The Securities and Exchange Commission of Nigeria established a National Committee for the review of the 2003 Code of Corporate Governance for Public Companies in Nigeria in September 2008 as part of its efforts to strengthen corporate governance practices in Nigeria. This move gave birth to the new code of corporate governance in 2011 believed to ensure the highest standards of transparency, accountability and good corporate governance among public companies in Nigeria (SEC, 2011).

However, due to the growing incidence of company failures both within and outside Nigeria, financial operators, investors, financial market authorities, and academic researchers are paying more attention to profit management. Most opportunistic discretions that result in fraudulent earning managements, according to Obeten *et al.* (2014), were traced to weak corporate governance. As a result, various researches have been conducted to investigate the relationship between corporate governance structures and practices of earnings manipulation. Surprising, the findings of the prior studies on the subject matter have generated divergent results (Garcia-Meca and Sanchez-Ballesta, 2009; Hassan and Ahmed, 2012; Ugbede *et al.*, 2013; Okougbo and Okike, 2015; Igodo, 2017; Eze, 2017; Tran *et al.*, 2020; Kyere and Ausloos, 2021).

It was also observed that previous relevant studies conducted in Nigeria substantially investigated earnings management from the dimension of board attributes as measures of corporate governance (Omoye and Eriki, 2014; Okoye *et al.*, 2016; Daniya *et al.*, 2016; Madugba and Ogbonnaya, 2017; Osemene *et al.*, 2018; Siyanbola *et al.*, 2019; Ideh *et al.*, 2021) with little attention on the dimension of assurance quality and ownership structure. These neglected mechanisms are equally important like

board attributes as enshrined in the 2011 and 2018 codes of corporate governance issued separately by Security and Exchange Commission (SEC) and Federal Reporting Council of Nigeria (FRCN) respectively. This omission may be significant in identifying key mechanisms of corporate governance that restrain the opportunistic practices of earnings management among corporate managers of public entities, hence necessitate further research into other measures of corporate governance.

In order to uncover a probable reason for earlier research' contradictory findings and significance of key mechanisms of corporate governance, this present study looked at earnings management of publicly traded consumer goods firms in Nigeria from the perspectives of board attributes, assurance quality and ownership structure. The study hypothesizes the followings in light of the arguments raised:

H01: There is no significant relationship between board attributes and earnings management of listed consumer goods firms in Nigeria.

H02: Assurance quality has no significant relationship with earnings management of listed consumer goods firms in Nigeria.

H03: Ownership structure does not have significant relationship with the earnings management of listed consumer goods firms in Nigeria.

Methodology

The study employed an ex post facto quantitative research design, which was found suitable for this research. The study's population comprised of twenty-one consumer goods companies that were listed on the NSE as of June 4, 2022. A purposive selection technique was used to choose only twelve listed companies that have routinely traded on the NSE for the past ten years, from 2012 to 2021. Secondary data were gathered from the selected companies' financial reports. The followings are the variables' measurements, which were built based on previous related studies on corporate governance influencing profits management practices:

a. Dependent Variable: Discretionary accruals

The study employed Modified Jones Model as the most commonly used model to estimate discretionary accrual being proxy for earnings management. The Modified Jones Model (MJM) is presented below:

Modified jones model

$$TA/A_{it-1} = \beta_1 (1/A_{it-1}) + \beta_2 (\Delta \text{ in Rev}_{it} - \Delta \text{ in Rec}_{it}) / A_{it-1} + \beta_3 (PPE_{it}/A_{it-1}) + e_{it}$$

TA = Operating income - Cash from operating activities

Where:

Assets at the beginning of the year, ΔRev_{it} = Change in sales from year t-1 to t, ΔRec_{it} = Change in receivables from year t-1 to t, PPE_{it} = Plant, Property and Equipment, $\beta_1, \beta_2, \beta_3$ = Represents firms specific parameters, ϵ_{it} = Residual value here represents the firm specific discretionary portion of accruals.

However, while the right side of the equation represents the non-discretionary accruals, the net result for the left side represents the total accruals. Hence taking the difference between the two sides, it amounts to the discretionary accruals.

b. Independent variables

Two dimensions of board attributes of this study were board's independence and audit committee financial expertise. Board Independence was measured by the proportion of non-executive directors to the total board's members (Ideh, *et al.*, 2021 and Okolie and Uwejean, 2022) while Audit Committee Financial Expertise was defined as the percentage of members with financial knowledge to the total number of members on the Committee.

Two dimension of assurance quality were proxied by auditor's tenure and audit fees. Auditor's tenure was defined as the proportion of the years spent with the client to the maximum number of 10 years allowed by the codes of corporate governance as captured the SEC and FRCN. Audit fee is measured by log of total fees (Lin and Hwang, 2010). Two dimensions of ownership structure were managerial and institutional ownerships. The first dimension was measured by the number of equity shares owned by the management, affiliates and subsidiaries to the number of company shares outstanding (Agustia, 2013 and Susanto *et al.*, 2021). Institutional ownership was defined as the proportion of the number of shares owned by institutional investors (financial institutions (insurance companies, Pension fund, investment banking) and other institutions to the number of company shares outstanding (Alzoubi, 2015 and Susanto *et al.*, 2021).

Control variables

The study included three control variables as firm's attributes that are capable of influencing earnings manipulation practices. In this study, the control

TA = Total Accruals (Non-discretionary accrual (NDA) + discretionary accrual (DAC)), A_{it-1} = Total variables were firm size proxied by log of total assets, financial leverage proxied by debt-asset ratio, and tangibility of assets measured by fixed assets to total assets ratio (Mulyadi, 2022)

Model specification

In the literature, there are different methodologies used in examining corporate governance and earnings management of listed firms. However, this study adopted the model used by Ideh *et al.* (2021) with a slight modification. The functional specification of the model takes the following form:

$DAC = f(BIND, ACFE, AUT, AUF, MOWN, IOWN, FS, LEV, ATANG)$

The econometric specification is as follows:

$DAC_{it} = b_0 + b_1(BIND)_{it} + b_2(ACFE)_{it} + b_3(AUT)_{it} + b_4(AUF)_{it} + b_5(MOWN)_{it} + b_6(IOWN)_{it} + b_7(FS)_{it} + b_8(LEV)_{it} + b_9(ATANG)_{it} + \epsilon_{it}$

Where:

DAC = Accrual based Earnings Management, BIND = Board Independence, ACFE = Audit Committee Independence Expertise, AUT = Auditor's Tenure, AUF = Audit Fee, MOWN = Managerial Ownership, IOWN = Institutional Ownership, FS = Firm Size, LEV = Financial Leverage, ATANG = Assets Tangibility, b_0 = Intercept for X variable of firms, $b_1 - b_9$ = coefficients for the independent variables of firms, denoting the nature of relationship with dependent variable (or parameters), $\epsilon_{it} = u_i + v_{it}$ (one way error component model), u_i = The unobservable individual specific effect of the cross-sectional unit, v_{it} = The stochastic disturbance term, i = individual unit (e.g. a consumer goods firm) in a cross section, t = time dimension. A *priori* expectation: There is an expectation of a significant negative relationship between corporate governance mechanisms and earnings management i.e. $b_1, b_2, b_3, b_4, b_5, b_9 < 0$.

Results and discussion**Descriptive statistics**

As presented in Table 1, the descriptive statistics showed the number of observations, means, standard deviation, minimum and maximum of the variables used in this study.

Table 1: Descriptive Statistics for the selected Consumers Goods Firms in Nigeria

Variables	No of Obs.	Mean	Std. Deviation	Minimum	Maximum
DACC	120	0.1281	0.0711	0.0797	0.5765
BIND	120	0.7180	0.1015	0.4444	0.8888
ACFE	120	0.2943	0.1314	0.1428	0.6250
AUT	120	0.5075	0.2685	0.1000	1.2000
AUF	120	6.7731	1.2783	4.7480	9.7728
MOWN	120	0.0657	0.1789	9.74E-06	0.7474
IOWN	120	0.7013	0.1237	0.4741	1.3121
FS	120	7.7304	0.6777	6.2404	8.7361
LEV	120	0.1535	0.1046	0.0068	0.5035
ATANG	120	0.5567	0.2045	0.1655	1.0007
Valid N (Likewise)	120				

Researcher's Computation, 2022

A careful look at the table reveals that average profit management practices (discretionary accrual) of quoted consumer goods firms in Nigeria is 12.18% with the minimum value of 7.97% and maximum value of 57.65% while standard deviation is 10.15% indicating that the earnings management practices deviate significantly from mean to both sides by 10.15% among quoted consumer goods firms in Nigeria. The descriptive statistics also reveal that corporate governance mechanisms measured by board independence, audit committee financial expertise, auditor tenure, audit fee, managerial ownership, institutional ownership have mean values ranging

from 0.7180 for board independence to 0.7013 in institutional ownership with their standard deviations of 0.1015, 0.1314, 0.2685, 1.2783, 0.1737 and 0.6777 respectively. This indicates a wide variation in the mechanisms of corporate governance among the selected quoted firms in Nigeria.

More so, control variables proxied by firm size, leverage and asset tangibility read a mean value of 7.7304, 0.1535 and 0.5567 with standard deviation is 67.77%, 10.46% and 20.45% indicating that control variables of this study vary among the selected listed consumer goods firms in Nigeria.

Correlation analysis

The correlation matrix for the variables was reported in Table 2 in order to examine the correlation that exists among the variables.

Table 2: Correlation Matrix of all variables (2012 -2021)

VARIABLES	DACC	ACIND	ACD	AUDFS	AUDTEN	MOWN	FOWN	FS	LEV	ROA
DACC	1.0000									
BIND	0.3401	1.0000								
ACFE	-0.0243	0.1460	1.0000							
AUT	0.0274	0.1303	-0.0378	1.0000						
AUF	0.0025	0.0487	0.4791	-0.1366	1.0000					
MOWN	-0.0577	0.1671	0.2691	-0.0960	0.7019	1.0000				
IOWN	0.0242	-0.1214	0.0291	0.1043	0.3223	0.0819	1.0000			
FS	-0.4872	-0.2823	0.3342	-0.1774	0.1465	0.1956	-0.0727	1.0000		
LEV	0.0480	0.0448	0.3721	-0.1147	0.3823	0.2955	0.0143	0.3561	1.0000	

ATANG	-0.1524	-0.0016	0.4254	0.1429	0.2618	0.1709	0.2089	0.3328	0.3192	1.0000
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Researcher's Computation, 2022

The results depicts that there is positive and negative association between discretionary accrual (DACC) and explanatory and control variables (mechanisms of corporate governance and control variables). Correlation coefficients among the independent variables range from -0.16% to 47.91%. This correlation matrix reflects the relative strength of the linear relationship between these variables. According to Gujarati (2004), multicollinearity could only be a problem if the pair-wise correlation coefficient among regressors is above 0.80. The result therefore suggests that most cross-correlation terms for the independent variables are fairly small, thus, giving little cause for concern about the problem of multicollinearity among the independent variables.

Multicollinearity test

Panel least squares estimation method implicitly assumes that there is a lack of perfect or nearly perfect correlation between the independent variables. To test for any potential presence of multicollinearity among the independent variables, a further investigation was conducted through the use of the variance inflation factors (VIF) test.

Table 3: Variance Inflation Factor

VARIABLES	VIF	1/VIF
BIND	1.3182	0.7585
ACFE	1.7972	0.5564
AUT	1.1462	0.8724
AUF	3.2081	0.3117
MOWN	2.3310	0.4289
IOWN	1.3290	0.7524
FS	1.6217	0.6166
LEV	1.3949	0.7168
ATANG	1.4653	0.6824
Mean VIF	1.7346	

Researcher's Computation, 2022

The variance inflation factor is shown in Table 3 to illustrate the association between the study's independent and control variables. According to the general rule, any variable with a VIF larger than 10 is extremely collinear, and vice versa. The VIF of each independent variable is less than 10, as shown in the table, showing that multicollinearity is not an issue.

It was also observed that the mean aggregate value of VIF (1.7346) is less than 10 suggesting an absence of multicollinearity as stated by Field (2009)

Table 4: Regression Result for Corporate Governance Mechanisms on Earnings Management of Listed Consumers Goods Firms in Nigeria

Dependent Variable: DACC

Method: Panel Least Squares

Total panel (balanced) observations: 120

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.418827	0.121027	3.460607	0.0008
BIND	0.138748	0.062341	2.225617	0.0081
ACFE	0.046196	0.056222	0.821683	0.4130
AUT	-0.016005	0.021977	-0.728267	0.0080
AUF	-0.000807	0.007724	-0.104415	0.9170
MOWN	-0.027114	0.047048	-0.576309	0.0056
IOWN	0.021883	0.051370	0.426000	0.6709
FS	-0.053450	0.010359	-5.160030	0.0000
LEV	0.157446	0.062242	2.529599	0.0128
ATANG	-0.026699	0.032631	-0.818214	0.4150

R-squared	0.539391	Mean dependent var	0.128146
Adjusted R-squared	0.485341	S.D. dependent var	0.071141
S.E. of regression	0.060141	Akaike info criterion	-2.704605
Sum squared resid	0.397859	Schwarz criterion	-2.472314
Log likelihood	172.2763	Hannan-Quinn criter.	-2.610270
F-statistic	6.279230	Durbin-Watson stat	2.082446

Prob(F-statistic)

0.000000

Researcher's Computation, 2022

Table 4 presents the result of regression analysis based the model adopted for investigating the reaction of earnings management in response to the various mechanisms of corporate governance employed by the selected firms in Nigeria. The result shows the coefficient of determination (R-square) with a value of 0.5394 which indicates that about 54% of the total systematic variation in profit manipulation of the selected firms in Nigeria can be explained by the explanatory variables of the study (BIND, ACFE, AUT, AUF, MOWN, IWON, FS, LEV, ATANG). The adjusted R-square reveals that even after making provision for the degree of freedom, the model could still explain about 49% of the total systematic variation in profit manipulation. The result suggests that only about 51% of the total systematic variation in the dependent variable was left unaccounted for by the model which has been captured by the error term in the model. The result of F statistic also confirms that the overall model was statistically significant with F value = 6.2792 and p- value = 0.00000 which is lower than 1% level of significance. The result affirms that there is a significant relationship between the explanatory variables and dependent variable of the study. The description of each independent variable in relation with the dependent variable is however presented as follows:

As presented by table 4, the individual influence of each of board attributes investigated in this study, shows that only board independence recorded a significant impact ($\beta = 0.1387$; $t = 2.2236$; $p < 0.05$) on the variation in earnings management while audit committee financial expertise was not found to make significant positive impact ($\beta = 0.0462$, $t = 0.8217$, $p > 0.05$) to the variation in earnings management of the selected firms in Nigeria. The result suggests that board attributes (board independence) has significant influence on the earnings management of the sampled firms in Nigeria. The study therefore rejects the null hypothesis that says board attributes do not have significance influence on the earnings management of the selected firms in Nigeria. The outcome of the analysis indicates that an addition of 1% increase in board independence (inclusion of more non -executive directors in the board composition) will result in an increase 4.62 in the opportunistic practices of profit manipulation of the selected firms in Nigeria. This investigation provided evidence that is contrary to the previous studies of Idel *et al.*, (2021); Siyanbola *et al.*, (2019).

In relation to the assurance quality, the individual influence of each of the explanatory variables revealed that auditor tenure ($\beta = -0.0160$; $t = -0.7283$; $p < 0.05$) is inversely related to earnings manipulation while audit fee failed to have significant inverse impact ($\beta = -0.0008$; $t = -0.1044$; $p > 0.05$) on the explained variable of the study. The result suggests that at 5% level of significance, it can be affirmed that assurance quality has significant influence on the profit management of the sampled firms in Nigeria. The study therefore fails to accept the null hypothesis that says assurance quality does not have significance influence on the earnings management of the selected firms in Nigeria. The finding indicates that 1% increase in audit tenure will result in 1.6% decrease in the unprofessional practices of profit manipulation of the selected firms in Nigeria. The result of the study therefore conforms to the proposition of agency theory which recognizes that shareholders' interests can be protected from being jeopardized by the managers' self-interest, through the use of high-quality assurance services as stringent control measure to mitigate opportunistic practices of profit manipulation. This finding failed to concur with the previous studies of Jayeola *et al.*, 2017; Eribe and Debor, 2017 that established that audit quality impacted positively on the practices of earnings management in Nigeria. However, Yusuf (2020) provided that audit quality has significant negative influence on earnings management in Nigeria.

As regards the ownership structure, the result depicts that managerial ownership exhibit negative but significant relationship ($\beta = -0.0271$; $t = -0.5763$; $p < 0.05$) with earnings manipulation at 5% level of significance whereas institutional ownership ($\beta = 0.0219$; $t = 0.4260$; $p > 0.05$) was not found to give a significant impact on the practices of earnings management of the sampled firms in Nigeria. However, the outcome of this study reveals that at 5% level of significance, ownership structure in terms of managerial ownership has significant impact on the earnings management of the sampled firms in Nigeria. The study therefore rejects the null hypothesis that says ownership structure does not have significance influence on earnings management of the selected firms in Nigeria. The finding indicates that an increase in managerial ownership could translate into a decrease in the opportunistic practices of profit manipulation. The strength of the influence is to the extent that 1% increase in managerial ownership could

lead to about 2.7% fall in the practices of profit manipulation of the sampled firms in Nigeria. The finding is consistent with previous similar studies carried out by Obigbemi *et al.* (2017); Ekpulu and Omoye (2018) and Osemene, *et al.* (2018) who establish a negative and statistically significant impact of managerial ownership on the earnings manipulation of consumers' goods' firms in Nigeria.

Conclusion and recommendations

The study carried out an empirical analysis investigating the connectivity between the selected mechanisms of corporate governance and earnings management of consumers' goods firms in Nigeria. Based on the empirical evidence obtained from the analysis, the study concludes that mechanisms of corporate governance exerted strong influence on the earnings management of the sampled firms in Nigeria. The study therefore recommends that corporate policymakers should develop relevant monitoring framework that will compel quoted firms in Nigeria to fully comply with the global best practices of corporate governance aimed at restraining opportunistic practices of earnings management. Efforts should also be made to ensure that corporate managers own certain proportion of shares in the companies they manage as this will propel them to act in the best interest of the company.

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