THE MODERATING EFFECT OF FOREIGN OWNERSHIP ON AUDIT COMMITTEE CHARACTERISTICS AND EARNINGS MANAGEMENT IN NIGERIA

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ABSTRACT

Managers in large organizations may manipulate earnings reports to suit their desire at the detriment of shareholders and other stakeholders. This may threaten the continuous survival of the organizations. To protect their interest shareholders through the board mandate audit committee to monitor the financial reporting process. The objective of this study is to examine a relationship between audit committee and external audit characteristics and earnings management in Nigeria. The study also investigates the moderating role of foreign ownership on the relationship between audit committee and external audit characteristics and earnings management. In addition, it also investigates the extent of earnings management before and after the revision of the code of corporate governance. Secondary data is collected for a sample of 93 nonfinancial public companies listed in the Nigerian Stock Exchange (NSE) for the period of 2009-2014. This study conducts multiple linear regressions using pooled OLS. Earnings management is measured by the level of discretionary accruals using modified Jones model (1995). Audit committee and external audit characteristics are discussed from the perspective of agency theory and resource dependence theory. The study finds that the size and independence of audit committee and external auditors' type are negatively related to earnings management before and after the moderation; audit committee overlapping positively affects earnings management before and after the moderation; while external auditors' independence and female director in audit committee positively affect earnings management prior to moderation; audit committee meeting is negatively related to earnings management only after the moderation. The study also finds higher earnings management prior to the revision of corporate governance code. This study recommends further policies that will increase foreign ownership in firms because it enhances corporate governance mechanisms and boosts the economy of the country.

Keywords: earnings management, corporate governance, audit committee characteristics, external audit characteristics, foreign ownership

ABSTRAK

Pengurus dalam organisasi besar boleh memanipulasi laporan pendapatan untuk memenuhi hasrat merugikan para pemegang saham dan pihak berkepentingan lain. Hal ini mungkin mengancam keterusan survival sesebuah organisasi. Untuk melindungi kepentingan pemegang saham melalui mandat lembaga, jawatankuasa audit memantau proses pelaporan kewangan. Objektif kajian ini adalah untuk menyelidik hubungan di antara jawatankuasa audit dan ciri-ciri audit luaran dengan pengurusan pendapatan di Nigeria. Kajian ini juga menyelidik peranan pemilikan asing yang mengantarakan hubungan di antara jawatankuasa audit dan ciri-ciri audit luaran dengan pengurusan pendapatan. Di samping itu, kajian ini turut meninjau sejauh mana pengurusan pendapatan sebelum dan selepas semakan kod tadbir urus korporat. Data sekunder dikumpulkan bagi sampel 93 buah syarikat awam bukan kewangan yang disenaraikan di Bursa Saham Nigeria (NSE) untuk tempoh 2009-2014. Kajian ini mengendalikan pelbagai regresi linear menggunakan OLS yang disatukan. Pengurusan pendapatan diukur dengan tahap akruan budi bicara menggunakan model Jones yang diubahsuai (1995). Jawatankuasa audit dan ciri-ciri audit luaran dibincangkan dari perspektif teori agensi dan teori pergantungan sumber. Kajian mendapati bahawa saiz dan kebebasan jawatankuasa audit serta jenis juruaudit luaran mempunyai kaitan negatif dengan pengurusan pendapatan sebelum dan selepas pengantaraan; Jawatankuasa audit bertindih secara positif mempengaruhi pengurusan pendapatan sebelum dan selepas pengantaraan; Sementara kebebasan juruaudit luar dan pengarah wanita dalam jawatankuasa audit positif mempengaruhi pengurusan pendapatan sebelum pengantaraan; Mesyuarat jawatankuasa audit pula berkait dengan pengurusan pendapatan hanya selepas pengantaraan. Kajian ini juga mendapati pengurusan pendapatan yang lebih tinggi sebelum semakan semula kod tadbir urus korporat. Oleh itu, kajian ini mencadangkan dasar lanjutan yang akan meningkatkan pemilikan asing di firma kerana hal ini meningkatkan mekanisme tadbir urus korporat dan meningkatkan ekonomi negara.

Kata kunci: pengurusan pendapatan, tadbir urus korporat, ciri jawatankuasa audit, ciri audit luaran, pemilikan asing

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LIST OF ABBREVIATIONS

AEM	Accrual-based Earnings Management
ACSIZE	Audit Committee Size
ACIND	Audit Committee Independence
ACEXPERT	Audit Committee Expertise
ACMEET	Audit Committee Meeting
ACOL	Audit Committee Overlapping
AP	African Petroleum
ATO	Asset-Turnover
AWD	Akintola Williams Deloitte
Big 4	Big 4 Audit Firms
BRC	Blue Ribbon Committee
CAC	Corporate Affairs Commission
CAMA	Companies and Allied Matters Act
CBN	Central Bank of Nigeria
CEO	Chief Executive Officer
CFA	Center for Financial Market Integrity
CFO	Cash Flow from Operating Activities
COGS	Cost of Goods Sold
CPI	Corruption Perception Index
EAIND	External Auditor's Independence
EAT	External Auditor Type
FE	Fixed Effect
FDI	Foreign Direct Investment
FIRS	Federal Inland Revenue Service
FMDIRECT	Female Audit Committee Member
FO	Foreign Ownership
FRCN	Financial Reporting Council of Nigeria
FSM	First-tier Securities Market
GAAP	Generally Accepted Accounting Principles
GLS	Generalized Least Squares
ICAN	Institute of Chartered Accountants of Nigeria
IFRS	International Financial Reporting Standard
IPO	Initial Public Offering
NAICOM	National Insurance Commission of Nigeria
NAS	Non-Audit Service
NASB	Nigerian Accounting Standard Board
NDIC	Nigerian Deposit Insurance Corporation
NED	Non-Executive Director
NGN	Nigerian Naira
NSE	Nigerian Stock Exchange
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
PENCOM	Pension Commission of Nigeria
PLC	Public Limited Company
PM	Profit Margin
RE	Random Effect
RDT	Resource Dependence Theory
REM	Real activities Earnings Management

ROSC	Report on the Observance of Standards and Codes
SAS	Statement of Accounting Standards
SEC	Securities and Exchange Commission
SEO	Seasoned Equity Offering
SSM	Second-tier Securities Market
TI	Transparency International
UK	United Kingdom
US	United States

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Management uses financial reporting and disclosure to convey firm performance and its governance to the shareholders and other stakeholders such as debt-holders, rating agencies and regulators (Healy & Palepu, 2001). The disclosure is done via regulated financial reports, which comprise of financial statements, management discussions or analysis, notes to the accounts as well as regulatory filings.

However, for the managers to effectively communicate firm performance, they must be allowed some level of freedom to exercise best judgment in the process of financial reporting, because they understand the firm better (Healy & Wahlen, 1999). In exercising the judgment, managers sometimes are motivated to choose reporting methods and estimates that suit their interest not the interest of the shareholders by managing earnings (Healy & Wahlen, 1999). The conflict of interest mostly arise in a typical large corporations where ownership and control are separated (Fama & Jensen, 1983). The genesis of the conflicting interests between management and shareholders is the central idea of the agency theory. This theory explained opportunistic tendency of management that made them to manage earnings. Agency relationship is "a contract under which one or more persons (the principal) engage another person (the agent) to perform some service on his behalf which involves delegating some decision making authority to the agent". When the parties in that relationship are rational, it is natural for the agent to protect personal interest not that of the principal (Jensen & Meckling, 1976, p.5).

Agency problem also arises in this type of relationship when the desire of the principal and that of the agent clashes with each other and it is hard or costly for the former to authenticate what the latter does (Eisenhardt, 1989). Consequently, the management (agents) exploits the information asymmetry advantage and freedom given to them to exercise best judgment in the process of financial reporting to manipulate earnings for their own advantage (Scott, 2003). Managers generally, engage in earnings manipulation because they knew that shareholders, prospective investors and analysts consider earnings as the most important indices in financial statement. Earnings management happens when managers distort the process of financial reporting for personal gain (Schipper, 1989). Despite the dominance of agency theory in earnings management researches, this study explores additional other theories such as the resource dependence and gender theories to explain the concept. A multi-theoretical approach to studies have been advocated (Daily, Dalton & Cannella, 2003; Hillman, Withers & Collins, 2009) .

Accordingly, earnings management is classified into either real earnings management (REM) or accrual-based earnings management (AEM). REM happens when a company for example reduces discretionary expenses substantially to enhance margins, give price rebate excessively to boost sales temporarily, or over produce to lower cost of goods sold (COGS) (Braswell & Daniels, 2017; Bens, Nagar, Skinner & Wang, 2003; Roychowdhury, 2006). Conversely, AEM occurs when a company adjusts accruals without the inducement of actual economic value. For example delay in assets write-offs and under provision of bad debts (Dechow, Sloan, & Sweeney, 1995; Roychowdhury, 2006). Earnings management is unobservable from financial statement directly; its estimation has to be through a type of a model (Spohr, 2005). This led to development of various methods of measuring earnings management. The most popular model being the discretionary accruals methods such as Jones model (1991) modified Jones model (1995), Kothari, Leone and Wasley model (2005). This study used modified Jones model (1995) because of its popularity and estimation power (Abdul Rahman & Ali, 2006; Habbash, Xiao, Salama, & Dixon, 2014; Sáenz González & García-Meca, 2014).

Further research on earnings management is important considering continued global cases of corporate collapse. According to Ronen and Yaari (2008), the series of prominent accounting scandals such as Xerox's where the company overstated profit of about $1.4 billion within four years. The company engaged in aggressive accounting by booking extra revenue or shift revenue from the future periods to the current period by discounting rate of leases in Latin America projected to reach about $447million (Pacot, Ruiz, & Virador, 2013). Furthermore, Xerox branch in Mexico failed to write off their rising bad debt and improperly classified some transactions to balloon their revenue (Pacot *et al*., 2013). In the case of Enron, the top management concealed debt dishonestly, overstated earnings and seek personal wealth through advanced sale of stock that led to the collapse of the company in December 2001, despite being the seventh largest corporation in the US then (Petrick & Scherer, 2003). These contributed in eroding the confidence of investors. It further shows that earnings management and corporate scandals affect all countries including developed economies (Pandit, Conway, & Baker, 2017).

In Nigeria, the collapse of Oceanic Bank due to financial irregularities and falsification of financial statement led to the sacking of the management and eventual prosecution and imprisonment of the managing director in 2009 (Sanusi, 2010). The Central Bank of Nigeria (CBN) had to take over the bank to protect customers' deposits (Sanusi, 2010). Despite the takeover, the share price of the bank drastically dropped at the detriment of the shareholders. Gunu (2009) reported that 36 banks closed down between 1994 and 2003 because of unethical practice by the management, which affected shareholders and other stakeholders. Prior to their collapse, the banks were reporting good financial indices. Similarly, in 2006 Cadbury (Nigeria) Plc (public limited company) was found to have deliberately overstated their earnings since 1997 to the tune of $85million-$100million (Abdullahi, Enyinna, & Stella, 2010). Shareholders were seriously affected when the share price of the company dropped from (Nigerian Naira) NGN54.15 per share as at December 12, 2006 to NGN 27.90 following this disclosure (Abdullahi *et al*., 2010). The share price continues to nose-dive to NGN 8.65 in October 2009 (Okaro & Okafor, 2013).

Consequently, Beasley (1996), Dechow and Skinner (2000), Dechow, Sloan, and Sweeney (1996), and Levitt (1998), amongst researchers and regulators, have recommended good corporate governance as a solution to the threat of earnings management. It is documented that corporate governance could mitigate earnings management by improving the quality of financial reporting (Man & Wong, 2013).

Therefore, the term corporate governance is defined as a tool through which external investors safeguard their investment from management's extortion (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). It is also been defined broadly " as the determination of the broad uses to which organizational resources will be deployed and the resolution of conflict among the myriad of participants in organization" (Daily *et al*., 2003, p.371). This definition extends beyond conflict and conflict-resolution between shareholders and managers, it includes other stakeholders such as employees, debt-holders etc.

Several types of corporate governance system exist such as Anglo-Saxon, German and Japanese system (Man & Wong, 2013). Nigeria inherited Anglo-Saxon system from her former colonial masters-the UK (Franks & Meyer, 1994; Okike, 2007). Accordingly, the corporate governance mechanisms can be either external or internal. External controlling mechanisms include labor markets for executive management and corporate control, debt and block holding by shareholders (Ali & Sanda, 2001). The internal mechanisms on the other hand, which is the focus of this study include the board, subcommittees (like audit or remuneration committee), as well as the voting rights of shareholders regarding important company decisions (Wang, 2010). The most important internal mechanisms is the board of directors to which shareholders delegate the responsibility of monitoring managers to protect their investment (Fama & Jensen, 1983; Imhoff, 2003). To this end, voluminous literature have been written on the board of directors as it relate to earnings management, which includes its size, independence, expertise and frequency of meetings (for example , Abdul Rahman & Ali, 2006; Arena, Bozzolan, & Michelon , 2015; Azzoz & Khamees, 2015; Malik, 2015; Peasnell, Pope, & Young, 2000; Talbi, Omri, Guesmi, & Ftiti, 2015; Wu, Chen & Lee, 2016).

In the 20[th] century, audit committee was introduced to offer an interface between external auditors and managers with the aim of enhancing the quality and integrity of financial reports (Imhoff, 2003). Considering the importance of the corporate governance and audit committee particularly, Nigeria issued first corporate governance code in 2003 and revised it in 2011 to make it more effective. Therefore, studying both audit committee, and effectiveness of the revised corporate governance code is important because one the goal of each is to enhance the integrity of financial reports. Despite the importance of audit committee and its presence in mitigating earnings management as argued by Defond and Jiambalvo (1991) and supported by Dechow, Sloan, and Sweeney (1996), its mere presence may not guarantee its effectiveness. The committee must have some features such as the right size, independence, expertise and activeness to ensure effectiveness (Crişan & Fülöp, 2014). However, studies on the impact of overlapping and female director in audit committee are scarce (Méndez, Pathan, & García, 2015; Thiruvadi & Huang, 2011) especially in developing country like Nigeria. This makes further research on them very important.

Furthermore, it was argued that auditing also plays a role in minimizing the existing information asymmetries between company stakeholders and managers. This is possible because it allows a verification of accounting numbers prepared by the managers (Becker, Defond, Jiambalvo, & Subramanyam, 1998). Equally, the audit has features that make it very effective such as the quality of the auditors and their independence. Accordingly, DeAngelo (1981), documents that audit quality differ among categories of auditors. That makes the study of external audit characteristics very important.

Notwithstanding the importance of audit committee, external audit and their characteristics in mitigating earnings management as established by many studies (for example, Arena *et* *al*., 2015; Bèdard, Chtourou, & Courteau, 2004; Dobija, 2015; Klein, 2002), controversy still exists among researchers on whether these charcteristics can effectively mitigate earnings management. For example, some studies established no relationship between audit committee and earnings management (Al-Thuneibat, Al-Angari, & Al-Saad, 2016; Kim & Yoon, 2016; Waweru & Riro, 2013). Others established negative relationship (Amar, 2014; Juhmani, 2017). Despite these mixed results, most countries strive to ensure good corporate governance and effective audit committee because good corporate governance especially effective audit committee attracts foreign investors according to Organization for Economic Cooperation and Development (OECD, 1999). Equally, it was argued that a weak corporate governance mechanism is one of the reasons why foreign investors are sometimes skeptical in investing in developing economies (Gibson, 2003; Mangena & Tauringana, 2007; Mckinsey & Company, 2001). Okike (2007) argues that enforcement with the code of corporate governance in Nigeria, which is the responsibility of Securities and Exchange Commission (SEC) has been weak with lenient penalties that cannot serve as warning.

Foreign ownership is the proportion of a company's equity possessed by foreign investors (Greenaway, Guariglia & Yu, 2014). The impact of foreign ownership in Nigeria needs to be explored because foreign investment contributes 46% of equity trading at the Nigerian stock exchange (NSE FPI report, June 2016). To maintain that investment and further boost it, the Nigerian government established Nigerian Investment Promotion Commission (NIPC) to attract and oversee foreign investment.

Furthermore, the United Nations Conference on Trade and Investment (UNCTAD) reported that foreign direct investment (FDI) inflow to Africa in 2014 fell to $38billion down by 31 percent from $54billion in 2013. The FDI of Nigeria fell by 27 percent from $4.7billion recorded in 2013 to a projected $3.4billion in 2014. Furthermore, a survey by Price Waterhouse (PwC) in 2017 states that the projection that Nigeria will be among the 14th largest economy in the world by year 2050 cannot be achieved unless the country boost its foreign investment. This underscores the importance of foreign investment in Nigeria.

Accordingly, extant studies have shown that relationship exist between foreign ownership and earnings management (for example, Desender, Aguilera, Puertas-Lamy & Crespi, 2014; Guo, Huang, Zhang & Zhou, 2015). However, the moderating effect of foreign ownership on the association between audit committee and external audit characteristics is yet to be explored. Therefore, this study differs from prior ones (example, Amar, 2014; Azzoz & Khamees , 2015; Crişan & Fülöp, 2014; Guo *et al*., 2015; Talbi *et al*., 2015; Waweru & Riro, 2013; Wu *et al*., 2016). Most of them examined either audit committee characteristics or foreign ownership in relation to earnings management. This study links the variables by investigating the moderating effect of foreign ownership on the association between audit committee and external audit characteristics and earnings management in Nigeria.

1.2 Problem Statement

Earnings management and integrity of financial reporting and disclosure have been subjects of discussion and concern among regulators, financial analysts and accounting practitioners, especially after the sequence of prominent accounting crisis and frauds involving renowned firms like Xerox, WorldCom and Enron (Stubben, 2010). This integrity of financial disclosure is hardly achievable as managers sometimes connive with auditors to manipulate earnings with the goal of increasing their personal wealth at the detriment of shareholders (Kothari, Mizik & Roychowdhury, 2015; Levitt, 1998). Furthermore, despite the publication of corporate governance codes globally like the US's BRC (1999), and the Sarbanes-Oxley Act (2002) reports, earnings management continues to receive global attention (McNichols, 2000; Stubben, 2010). Additionally, Kothari *et al*. (2015) and Levitt (1998) state that the voluminous literature on earnings management indicate that managers continue to falsify the financial information of firms with the interior motive of skewing the company's stock market price upward.

In Nigeria, in the late 1990s Lever Brothers (now Unilever Plc) and IPWA Plc used accounting manipulation to balloon their profits by including non-existing or obsolete stocks (Oseini, 2013). Similarly, African Petroleum (AP) in 2009 concealed debt of over NGN23billion using creative accounting during privatization (Samaila, 2014). In addition, CBN in 2009 found eight out of the nine commercial banks it audited guilty of financial misappropriation, and creative accounting, which led to their liquidation and taken over to the dismay of the shareholders (Sanusi, 2010). The banks include Oceanic Bank, Intercontinental Bank, Afribank, Spring Bank, Equatorial Trust Bank, Wema Bank, Fin

Bank and Bank PHB. These examples showed that the problem of earnings management has been in the history of Nigeria for a long time.

Several studies have been conducted on corporate governance with the aim of finding solution to opportunistic earnings management. However, most of them dwell on board and board characteristics (for example, Abbadi, Hijazi, & Al-Rahahleh, 2016; Abdullahi *et al*., 2010, Al-Thuneibat et al., 2016; Dechow *et al*., 1996; Foyeke, Olajide, Oluku, & Kolade, 2016; Habbash, Xiao, Salama, & Dixon, 2014; Kolsi & Grassa, 2017; Kumari & Pattanaya, 2014; Sáenz González & García-Meca, 2014; Uddin Bhuiyan, Roudaki, & Clark, 2013). In contrast, few other studies worldwide focused on audit committee characteristics (for example, Amar, 2014; Bédard, Chtourou, & Courteau, 2004; Crisan & Fulop, 2014; Juhmani, 2017; Klein, 2002; Xie, Davidson, & Dadalt, 2003; Fang, Huang, & Karpoff , 2015). Although, audit committee is a subcommittee of the board, in actual sense the committee is the one directly responsible for the oversight function of financial reporting and disclosure. Audit committee is responsible not the board to monitor the work of external auditors. It was further argued that most important board decisions are made within the boundaries of smaller groups or committees, but researchers inclined to focus on the characteristics of the entire board (Kesner, 1988). Despite the fact that the entire board of directors meet as a group to discuss issues or for voting purpose, most important decisions are made within a small committee (Kesner, 1988; Lorsch & Maclver, 1989). Therefore, researchers on earnings management and corporate governance should have focus more on audit committee characteristics rather than the entire board (Kesner, 1988; Klein, 2002).

Additionally, some audit committee characteristics such as the influence of gender diversity in lessening earnings management has not been studied extensively especially in African context (Arowolo & Che-Ahmad, 2016; Odewale, 2016). Women groups and civil societies (CSOs) in Nigeria continue to agitate for a fair share of positions in public companies arguing that women are more ethical and would serve as good monitors on management. For example, a non-governmental organization in Nigeria called women in management, business and public service (WIMBIZ) asserts that women are not only under-represented on boards in the political arena but also in the corporate sphere. Some countries have quota for women board representatives. For example, Malaysia has a law enacted since 2011 that reserve minimum of 30% positions for women in decision-making in corporate sector (Ammer, & Ahmad-Zaluki, 2017). Nigeria is yet to enact such law despite the continuous agitation and no provision for gender balance in audit committee in the revised corporate governance code. However, women groups in Nigeria are agitating for 35% affirmative action to enable them get 35% of all positions both political and corporate.

Similarly, in a report by African Development Bank (AfDB) in 2015, Nigeria though the most populous country in Africa with female accounting for 49.4% came eight out of twelve countries rated based on proportion of women on board with only 11.5 percent. Other smaller African countries such as Kenya, South Africa, Botswana, Zambia, Ghana, Tanzania and Uganda are far ahead. Therefore, empirical study on the impact of female director in audit committee with expectation that their presence will reduce earnings management practice is timely since some companies already have female in their audit committees. The result of this study if favorable would serve as a tool for further agitation.

Furthermore, there is a dearth of studies on overlapping in relation to earnings management (Mendez et al., 2015; Pathan, Wong & Benson, 2014). Audit committee overlapping is a multiple board committee membership by an audit committee member (Méndez, Pathan & Garcia, 2015). Overlapping members can either be good or worst monitors. Overlapping can facilitate knowledge sharing, which can help members in fulfilling their duties. However, it can cause paucity of time that can hinder members from carrying out their duties. The revised code of corporate governance (2011) did not proscribe multiple board or multiple committees but cautioned board to consider other commitment of the directors. This study predicts a significance association between audit committee overlapping and earnings management in Nigerian context.

Similarly, due to mixed results on the impact of board and audit committee on earnings management, prior studies introduced a moderating variable to strengthen the association between board characteristics and earnings management. For example, Miko (2016) used institutional ownership to moderate the association between board and only three audit committee characteristics (audit committee size, audit committee independence and financial expert in audit committee) and earnings management. Accordingly, this study explores the moderating role of foreign ownership on audit committee and external audit characteristics as it relates to accrual earnings management, which no prior study has considered. Foreign ownership is the proportion of company's equity possessed by foreign investors (Greenaway *et al*., 2014). Foreign investment is important to the survival of Nigeria's economy because it contributes 46% of the equity trading at the Nigeria stock exchange (NSE) (NSE FPI report, June 2016).

In a recent survey conducted by Price Waterhouse Cooper (PwC) in July 2017, the foreign direct investment (FDI) dropped to an 11-year low, which led to collapse of investment to gross domestic product (GDP) ratio to 12.6 percent. In absolute term, the total FDI in Nigeria stood at $1.269 billion as at January 2017 dropping from $1.386billion ("Trading Economics," 2017). This is the lowest in the last two decades according to the survey by PwC. The survey further projected Nigeria to be among the 14th largest economy in the world by the year 2050, with a GDP in market exchange rate terms at $3.3 trillion. The report concludes that the projection could only be achieved if the country aggressively boosts domestic and foreign investment. Apart from the importance of foreign investment to Nigerian economy, audit committee, external auditors and foreign investors can act as good monitoring mechanisms capable of reducing earnings management (Sanda *et al*., 2011). The major source of foreign investment in Nigeria is from US, China and Netherlands (Nigerian Bureau of Statistics, 2017). Although, these countries have varied corporate governance systems and regulations but in common, they all insist on quality financial reporting to ensure that their investment is safe. Furthermore, empirical studies have established association between foreign ownership and earnings management (for example, Desender *et al*., 2014; Guo, *et al*., 2015). However, none of them explores the moderating effect of foreign ownership on audit committee characteristics and earnings management.

Finally, following the revision of code of corporate governance in 2011 in Nigeria, this study compares the extent of earnings management in the pre-and-post periods. This study use level of earnings management to assess the effectiveness of the new code of corporate governance (2011).

Precisely, this study fills three main gaps: (1) empirically, compares the extent of earnings management before and after the revision of corporate governance code in 2011 in Nigeria

(2) Introduce two additional variables: female director in audit committee and audit committee overlapping to the framework of Miko and Kamardin (2015). (3) Investigate the moderating effect of foreign ownership on the association between audit committee and external audit characteristics and earnings management.

1.3 Research Questions

These questions are expected to be answered at the end of the study:

1) What is the extent of earnings management before and after the revised code of corporate governance 2011?

2) Do audit committee characteristics (size, expertise, female director in audit committee, independence, activity level and overlapping) significantly affect earnings management?

3) Do external audit characteristics (external auditors' type and external auditors' independence) significantly affect earnings management?

4) Does foreign ownership significantly moderates the association between audit committee and external audit characteristics and earnings management?

1.4 Research Objectives

This study has the objective of examining the moderating effect of foreign ownership on the association between audit committee characteristics and earnings management. The following are the specific objectives of the research:

1) To examine the extent of earnings management before and after the revision of corporate governance code 2011.
2) To examine the significant effect of audit committee characteristics (size, expertise, female director in audit committee, independence, activity level and overlapping) on earnings management.
3) To examine the significant effect of external audit characteristics (external auditors' type and external auditors' independence) on earnings management.
4) To examine the significant moderating role of foreign ownership on the association between audit committee and external audit characteristics and earnings management.

1.5 Research Motivation

According to World Bank report Nigeria has weak corporate governance system including weak financial reporting, auditing and accounting system (ROSC, 2011). This led to banking sector crisis in 2011. Secondly, World Bank ranked the country 169 out of 190 countries in the Ease of doing Business Index (2016). Among the 10 indices of the assessment, is the investor protection. This is not a comfortable position considering that Nigeria desires to encourage and attract foreign investment to boost the economy.

Thirdly, is the corporate scandals which equally affect Nigeria (e.g. Cadbury case, 5 bank CEOs) (Abdullahi et al., 2010; Sanusi, 2010). This indicates that managers still engage in earnings management for selfish interest. Finally, is the weak enforcement for non-compliance with the code of corporate governance in Nigeria. Bhatta *et al*. (2016) put forward that investors (especially foreign) are attracted to countries with strong corporate governance mechanism and strict penalties for non-compliance. In effect, functional institutions with authority could lead to compliance with the corporate governance and boost both domestic and foreign investment.

1.6 Scope of the Study

This study investigates the moderating effect of foreign ownership on audit committee and external audit characteristics and earnings management among public listed companies operating in the non-financial sector in Nigeria. The study also assesses the extent of earnings management before and after the revision of corporate governance code in 2011 using a paired sample t-test and split sample for pre-and-post revised code. The non-financial sector is selected for the reason that many of the studies on earnings management and corporate governance conducted in Nigeria have been on banks (for example, Akenbor & Ibanichuka, 2012; Ehimare *et al*., 2013; Kwanbo & Abdul-Qadir, 2013; Lauwo & Olatunde, 2010; Mohammed, 2011). Banks and insurance are not included in this study also because the industries are highly regulated by the CBN and National Insurance Commission (NAICOM).

Generally, the audit committee characteristics (independent variables) to be covered by the study are audit committee size, audit committee independence, audit committee expertise, female director in audit committee, audit committee meeting, and audit committee overlapping. Other independent variables are the external audit characteristics precisely external auditors' type and external auditors' independence because they relate to the functions of the audit committee. Foreign ownership is the moderating variable and earnings management is the dependent variable measured through modified Jones model (1995) and proxied by discretionary accruals.

Specifically, this study considers the period from 2009 to 2014. These six (6) years include three (3) years (2009-2011) before the revision of the 2003 code and another three (3) years after the revision (2012-2014). Six year (6) period is to be considered because of data availability and would allow comparability if the inception year (2011) is included among the 'before' years. The revised code came into effect on April 1, 2011. Therefore, its impact cannot be felt until 2012. Odewale (2016) equally include 2011 in the pre-years while studying extent of executive compensation in the pre-and post-corporate governance code (2011). The study used secondary data (annual reports) sourced from the fact book of the Nigeria Stock Exchange (NSE). The non-financial companies are 143 as at December 31, 2014 but the sample of this study is 93 companies under the first tier categorized into ten industries (NSE Fact sheet, 2014) based on data availability. This study only considers companies under the first tier security market (FSM). The FSM are big and well-capitalized companies. While, the second tier security market (SSM) are small companies with share capital of NGN20million and below.

The underpinning theory of the present study is agency theory, supported by resource dependence theory. The agency theory and resource dependence theory underpins the audit committee and external audit characteristics and expect lower earnings management.

1.7 Contributions of the Study

This study has theoretical, practical and methodological contributions:

1.7.1 Theoretical Contributions

Theoretically, this study contributes to corporate governance literature specifically the role of audit committee characteristics (size, independence, expertise, female director in audit committee, meeting and overlapping) and external audit characteristics (external auditors' type and independence) in mitigating earnings management. Similarly, the study examines the moderating effect of foreign ownership on audit committee and external audit characteristics and earnings management in developing economy such as Nigeria. Several studies have been conducted on audit committee and earnings management (Amar, 2014; Azzoz & Khamees, 2015; Crisan & Fulop, 2014; Guo *et al*., 2015; Juhmani, 2017; Kolsi, 2017; Komali, 2016; Talbi *et al*., 2015; Waweru & Riro, 2013; Wu *et al*., 2016). However, no study to the knowledge of the researcher explored the moderating role of foreign ownership on audit committee and external audit characteristics and earnings management.

Secondly, this study used a pre-and-post approach through paired-sample t-test to compare the level of earnings management before and after the revised code of corporate governance in 2011 in Nigeria.

Thirdly, this study used the framework of Miko and Kamardin (2015) and introduces two additional variables-female director in audit committee and audit committee overlapping. Studying these variables in association with earnings management in the Nigerian context is important contribution to literature.

1.7.2 Practical Contribution

This study has practical contributions to government through policy formulation especially on how to encourage foreign investment in Nigeria. Quality of financial reporting and strong corporate governance practice boost the confidence of foreign investors and positively influence FDI and other macroeconomic indices (OECD, 1999). Furthermore, listed companies operating in the non-financial sector in Nigeria will find the result of this study useful. It will enhance their knowledge on the importance of an effective audit committee and external audit. Similarly, findings from this study would benefit regulators such as Security and Exchange Commission (SEC) and the NSE in checking the excesses of some corporate organizations that engage in earnings management for personal benefits of the managers. In addition, other public institutions like Federal Inland Revenue Service (FIRS) who is responsible for tax assessment and collection would find this study beneficial because some companies manipulate earnings with the aim of evading tax.

Equally, the findings will also benefit the shareholders associations who are mostly at disadvantage when company collapses due to opportunistic earnings management. Prospective investors likewise need information that can guide them to make good investment decisions. Finally, commercial banks (lenders) and insurance companies would find this study important. Earnings management affects commercial banks because sometimes lenders find it difficult to recoup loans they advanced at the event of corporate collapse.

1.7.3 Methodological Contributions

From methodological perspective, this study measures a variable differently. For example, previous studies (Habbash *et al*., 2014; Saleh *et al*., 2005) measured leverage as a proportion of total debt to total assets, this study used proportion of interest-bearing debt to equity to measure leverage. Total debt to total assets measures total debt (short-term plus long-term debt). It is too broad because it uses total assets (current and non-current) as a basis for comparison. However, interest-bearing debt ratio is more specific that takes only interest bearing debt and compare with equity.

1.8 Outline of the Study

This study is structured into five chapters. Chapter 1 covers general introduction of the study. It comprises the background, problem statement, research questions, objectives, scope, motivation, contribution and outline of the research. Chapter 2 presents literature review, including definitions of earnings management, audit committee and external audit characteristics and review of related empirical studies. Chapter 3 discusses the theoretical framework, development of hypotheses and research methodology. Chapter 4 presents data analyses and discussions. Chapter 5 presents summary, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter primarily reviews the related literatures on earnings management, audit committee and external audit characteristics and foreign ownership. Finally, it conceptualizes the main concepts of the study and discusses related researches that are necessary in the development of hypotheses for this thesis.

2.2 Concept, Motives, and Measurement of Earnings Management

Earnings management has been the major worry for the ruling bodies even before the accounting scandals (for example, Enron, WorldCom) took place (Amar, 2014). It has evolved over time as voluminous literature has been written on it but without a consensus on it its definition (Yue, 2004). Despite the non-consensus, several scholars have attempted to define the concept. For example, Schipper (1989) defined earnings management as a deliberate interference in the external process of financial reporting to acquire some personal benefit instead of facilitating an impartial operation of the process. Others that defined earnings management from opportunistic behavior of management include Healy and Wahlen (1999), and Goel and Thakor (2003). Furthermore, from the regulators' understanding, Levitt (1998) stated that earnings management is a "… gray area where sound accounting practice is perverted; where managers cut corners; and where earnings reports reflect the desire of the management rather than the underlying financial performance of the company" (p.2).

Both academics and regulators' perception of earnings management reveal sign of opportunism, but the two differ on the magnitude. While some practitioners and regulators view earnings management as rampant and awkward that requires urgent action, some academics see it as mere optimism and less recurrent (Dechow, & Skinner, 2000). This might be the reason why some researchers debated that earnings management sometimes benefits firms. It is argued that earnings management improves the "information value of earnings by transmitting private information" to the shareholders (Jiraporn, Miller, Yoon, & Kim, 2008; Louis & Robinson, 2005). They argue that earnings management benefits firm in a situation where estimation of net receivables by managers indicates reliable forecast of cash collections.

Prior studies established presence of earnings management in financial reports of companies. However, they encounter difficulty in operationalizing the concept and in detecting the exact accrual or account managed from the reported accounting numbers (Dechow, & Skinner, 2000). Among several methods used by researchers to measure earnings management, accrual method has been popular and widely employed (Habbash *et al*., 2014).

2.2.1 Motivations for Earnings Management

There are two broad reasons for earnings management-the opportunistic and beneficial motive. It is said to be opportunistic when earnings is managed for personal interest of the managers against the interest of the shareholders (Defond & Jiambavlo, 1991; Habbash, & Alghamdi, 2015; Healy, 1985; Healy & Wahlen, 1999; Kothari, *et al*., 2015; Schipper, 1989; Walker, 2013; Sweeney, 1994).

In contrast, the motive can be beneficial to the company and to the shareholders. In this direction therefore, Dye (1988) postulates that when existing shareholders intend to inspire prospective investors' opinion on the value of their firm, the existing shareholders could personally ask managers to manage earnings to achieve that objective. This could not be so if earnings management is completely detrimental to the current shareholders. It was also argued that some accounting choices are seemingly credible indication of financial performance of a firm (Healy & Wahlen, 1999). For example, if estimation of net receivables by the managers is seen as reliable prediction of cash collections. Other studies equally proved that earnings management could be advantageous to firm and shareholders or as a signal (for example, Barnea, Ronen & Sadan, 1975; Chaney, Jeter & Lewis ,1998; Demerjian, Lewis-Western & McVay , 2015; Goel & Thakor, 2003; Jiraporn *et al*., 2008; Louis & Robinson, 2005; Myers & Majluf, 1984; Wang & Williams, 1994). Signaling theory suggests that earnings management is used as an indication that future earnings of firm are good (Anandarajan, Hasan, & McCarthy, 2007).

Despite the benefits of earnings management as discussed in the mentioned studies, this study focused on opportunistic side of it. This is because of the history of various corporate collapse and financial scandals experienced worldwide including Nigeria. For example, collapse of four commercial Banks in 2009 and the Cadbury case in 2006 in Nigeria (Abdullahi *et al*., 2010; Sanusi, 2010). Secondly, the poor rating of the country by Transparency International (TI) is another reason to assume that earnings management in Nigeria is likely to be more of opportunistic rather than informative. The TI rated the country 136 out of 167 countries in the corruption perception index (CPI, 2015; 2016). The corruption get across both public and private sectors (WorldBank ROSC, 2011). Although, corruption is not peculiar to Nigeria, but its prevalence pose corporate challenge that ought to be tackled. Some of the specific motives for opportunistic earnings management are discussed:

2.2.1.1 Stock Market Incentives

Managers opportunistically manage earnings for stock market reasons to increase the share price of their company or for the company to look less risky in the eyes of the shareholders (Eriksson, 2015; Goel & Thakor, 2003; Trueman & Titman, 1988; Xiong, 2006). Similarly, some researchers also considered motives for managing earnings from a particular capital market conditions such as initial public offering (IPO) or seasoned equity offering (SEO) (for example, Eriksson, 2015; Kothari *et al*., 2015; Rangan, 1998; Teoh, Wong & Rao, 1998). They respectively document high earnings manipulation in the year of season offering, or during IPO. Other reason is simply to increase share price of the firm (Habbash, & Alghamdi, 2015).

2.2.1.2 Contractual Motives

Watts and Zimmerman (1978) introduced positive accounting theory. It proposed non-capital market motive on why firms manage their earnings. Xiong (2006) points out that this theory changed the direction of earnings management study to firms' contractual motives. This theory proposed three hypotheses, which include bonus plan, debt covenant and political cost hypothesis. Each of them explained opportunistic motive of managers:

2.2.1.2.1 Bonus Plan hypothesis

Managers apart from their normal salaries enjoy other bonuses, which is a function of their performance usually measured by net income of the firm at end of the year. As such managers sometimes are incline to manage firm's earning by selecting accounting methods and exercise discretion over accounting estimates to improve the present value of their compensation (Watts and Zimmerman, 1978). Equally, studies establish that managers engage in earnings management to maximize their bonus, which depends on the company's earnings (Gu, & Hu, 2015; Habbash, & Alghamdi, 2015; Healy, 1995; Jones, 1991; Rahman, Moniruzzaman, & Sharif, 2013).

2.2.1.2.2 Debt Covenant Hypothesis

This hypothesis states that highly leveraged companies with high percentage of debt in their capital structure are more inclined to choose accounting methods that increase their earnings. This is to evade defaulting technically in debt agreement. A study by Defond and

Jiambalvo (1994), and Rahman *et al*. (2013) exert that debt contract mostly based on accounting numbers can inspire earnings management. A study in Saudi Arabia has shown that managers engage in an upward earnings management to secure a bank loan (Habbash, & Alghamdi, 2015). However, a decreasing incentive during import relieve investigation was established in the United States (Jones, 1991).

2.2.1.2.3 Political Costs Hypothesis

Another important reason why managers manage earnings is in response to external stakeholders (excluding shareholders). For example, a company may want to deceive government and tax authorities as users of financial reports by evading tax or concealing excessive profit (Watts and Zimmerman , 1978). Previous studies confirmed this assertion (for example, D'sousa, Jacob & Ramesh, 1999; D'sousa, Jacob, & Ramesh, 2001; Gu, & Hu, 2015; Jones, 1991; Rahman *et al*., 2013).

2.2.1.3 Job Security

Another reason for managerial opportunism is job security of the management. When managers are not performing, they tend to manage earnings to avoid possible sack. This is usually done by borrowing future profit into the present in anticipation of good performance later (Defond & Park, 1997; Fudenberg & Tirole, 1995; Gu, & Hu, 2015; Rahman *et al*., 2013). Accordingly, Zhang (2016), Chief Executive Officers (CEOs) of companies listed in Shanghai Stock Exchange and Shenzhen Stock Exchange engage in earnings management to retain their positions.

2.2.1.4 Making the Chief Executive Officer Look Good

Reitenga and Tearny (2003) found proof of earnings management in retiring CEOs final year and final two years with additional evidence when the CEO is to retain his seat on the board of directors after retirement. Similarly, a retiring CEO is inclined to manage earnings upward to leave stylishly. Also in line with this, a study by Chen, Luo, Tang, & Tong (2015) found that an interim CEOs are more likely to manage earnings upward than non-interim CEO in order to be promoted to a substantive position.

2.2.1.5 Avoiding Earnings Decreases and Losses

To avoid decrease in earnings and losses or to report positive earnings, firms are motivated to manage reported earnings (Burgstahler & Dichev, 1997; Degeorge, Patel, & Zeckhauser, 1999). Apart from being a motive for earnings management, avoiding earnings decrease or loss could be one of the methods used to detect earnings management.

2.2.2 Classification of Earnings Management

Earnings management is classified into real earnings management (REM) and accrual earnings management (AEM). REM is a deviation from the standard operational practices by the management. The aim is to deceive some stakeholders for them to believe that some financial reporting targets were achieved under normal business operations but without adding value to the firm in the actual sense of it (Enomoto, Kimura & Yamaguchi, 2015; Graham, Harvey, & Rajgopal, 2005; Roychowdhury, 2006; Schipper, 1989). For example, excessive decrease in discretionary expenditure like research and development (R & D) or intentional price discount to achieve or even surpass predetermined earnings. Roychowdhury (2006) posits that companies attempt to evade loss reporting using price rebates to escalate turnover temporarily, reduce cost of goods sold (COGS) through overproduction and improve margins by cutting down discretionary expenses. However, it was argued that the study by Roychowdhury (2006) though extensive failed to show how the choice between real earnings management and accrual earnings management is done especially when management has liberty to do both (Islam *et al*., 2011). Furthermore, is whether companies that are involved in REM consistently do such. This means whether real earnings management is a one-off exercise or the company can do it continually. Finally, Roychowdhury (2006)'s study could not solve the problem of timing associated with cash accounting, as real earnings management is done only through cash accounting not accruals.

On the other hand, accrual earnings management is earnings management done through accruals. Accrual is the variance between reported earnings and cash flow from operating activities (CFO) (Healy, 1985). It is earnings management done primarily using the flexibility allowed by the GAAP via a change in the process of accrual (Dechow, 1994; Enomoto *et al*., 2015). AEM has an advantage over REM because it has no problem of timing and matching associated with cash flows (Islam *et al*., 2011).

This research used accrual method to measure earnings management because it was used in many studies (for example, Dechow, 1994; Deangelo, 1986; Dechow *et al*., 1995; DuCharme, Malatesta, & Sefcik, 2001; Friedlan, 1994; Healy, 1985; Jones, 1991; Teoh *et* *al*., 1998). Additionally, it was established that firms can continually use accruals to manage earnings without being noticed at least in the short run but it is doubtful if they can use real earnings management repeatedly without users of the report get to know (Islam *et al*., 2011). Therefore, accrual earnings management can be more reliable measure of earnings management than REM because it is more widely practiced by managers in countries with weak investor protection (Enomoto *et al*., 2015). Nigeria has a weak investor protection (Odewale & Kamardin, 2015). This further justifies the use of AEM in this study rather than REM.

2.2.3 Methods of Detecting Earning Management

Because opportunistic earnings management has the tendency to mislead stakeholders, it is usually invisible and difficult to detect (Spohr, 2005). Researchers use proxy to detect it. Extant studies find that managers manage earnings through some of the following methods:

2.2.3.1 Accounting Choice

Accounting method choice include the selection of a particular accounting method (for example, choice on whether to capitalize an intangible asset or not), and how to apply that method (Spohr, 2005). Managers have option to decide when to report an event (for example, when to write off bad debt or impaired assets). This right of option allowed the managers to predetermine what earnings to report. For example, if they decide to report high earnings, they can delay to write off bad debt even if they know it is not realizable.

Equally, Teoh *et al*. (1998) establish that initial public offerring (IPO) firms applied depreciation method to increase their earnings. Managers also write off fewer bad debts significantly in the year before the IPO and the year of the IPO compared to non-IPO firms. In addition, managers select accounting policies that increase accounting earnings, decrease information production costs, reduce taxable income or lessen political costs (Watts & Zimmerman, 1978). Nevertheless, some studies are of the view that studying a single accounting method or timing choice at a particular time may not give a broader picture of firm's accounting choice. For example, Christie and Zimmerman, (1994) suggest a separation of each accounting choice into either income increasing or decreasing group and test it individually on sample firms.

2.2.3.2 Earnings Distribution

Burgstahler and Dichec (1997) establish that managers manipulate earnings in order to achieve a particular earnings target. Therefore, the earnings distribution will have more observations above expectation just higher than the threshold and fewer observations than anticipated just below the threshold. The evidence of earnings management is the discontinuity in the distribution of earnings. Accordingly, Degeorge *et al*. (1999) argue that managers struggle to report positive profit. They investigate discontinuities in the distribution of reported earnings around three thresholds: (1) report positive profit, (2) sustain preceding performance and (3) achieve analysts' expectations for the current year hierarchically in that order.

2.2.3.3 Assets Turnover and Profit Margin Model

Another interesting earnings management model developed by Jansen, Ramnath, and Yohn (2012) uses accounting model. Specifically, the model used the popular accounting ratios of assets turnover (ATO) and profit margin (PM) as proxies for earnings management. The model depends on the popular notion underlying DuPont analysis that sale is the most important driver for company's investment as well as income. Secondly, balance sheet ratio (net operating assets) and that of income statement (net operating income) should vary directly with sales. Therefore, a variation in the two ratios in the opposite direction might indicate earnings management. Jansen *et al*. (2012) provide evidence that simultaneous increase in PM and decrease in ATO signal management of earnings upward. Conversely, simultaneous decline in PM and raising ATO signal management of earnings downward. The model argues further that the model is more revealing about earnings management because it depends on important ratios in accounting unlike the accrual model that used estimate. Another pleasing feature of this model is that it is computable for any company with little data, unlike the accruals model, which requires a significant time series data sometimes from an entire industry. The believe is that numerous users of financial statements including shareholders use accounting ratios frequently for decision-making purposes even if they are not envisaging earnings management. The relation between ATO and PM ratios is:

ATO = Sales ⁄ Net operating assets;

PM = Operating income ⁄ Sales.

From the above, sales is the numerator and denominator in the calculation of ATO and PM respectively. Therefore, the two ratios should vary directly with sales. Jansen *et al*. (2012) argue that variation of the ratios in opposite direction indicates earnings management due to articulation of the balance sheet and income statement, which ensures that earnings management affects both net operating assets and operating income in the same direction.

2.2.3.4 Accruals Methods

There are two components to earnings, total accruals and cash flow from operating activities (Sun & Rath, 2010). Total accruals are estimates and judgments about cash flows used by managers to ensure that the accounting earnings reflect true financial performance of a company. Accrual is divided into discretionary and nondiscretionary. The accounting standard bodies enforced accounting regulations to the company's cash flow, which are nondiscretionary (Sun & Rath, 2010). However, the same accounting regulations allow some level of flexibility to managers to adjust company's cash flow, which are discretionary. The discretionary accruals are the proxy used for earnings management (Spohr, 2005). There are several accrual methods:

2.2.3.4.1 Healy (1985)

Healy (1985) is the first to introduce discretionary accruals in measuring earnings management. He however, used total accruals (discretionary and nondiscretionary combined) as a measure for earnings management. The model did not separate discretionary and nondiscretionary accruals since both are unobservable from financial statement. Another assumption of the model is that discretionary portion in a particular year is the same as total accruals scaled by lagged of total assets, and assume nondiscretionary to be zero. Healy (1985) further establish that management use accruals to boost their bonus. He used the following model:

$$DAC_{i,t} = \frac{TA_{i,t}}{A_{i,t-1}}$$

Where:

$DAC_{i,t}$ Stands for discretionary accruals for firm i in period t , $TA_{i,t}$ and $A_{i,t-1}$ stand for total accruals and total assets respectively for period t and t - 1

2.2.3.4.2 DeAngelo (1986)

DeAngelo (1986) used time series of Healy (1985) to estimate nondiscretionary accruals. The assumption of this model is the random walks approach of nondiscretionary accrual. Therefore, nondiscretionary accruals should be a variation in total accruals between year t-1 and year t. That is this year's nondiscretionary accrual is the total accruals of last year. DeAngelo (1986) establish that managers proposing a buyout in 64 US companies understate earnings in the year preceding the buyout.

Her model is:

$$DAC_{i,t} = \frac{(TA_{i,t} - TA_{i,t-1})}{A_{i,t-1}}.$$

The model further assumes nondiscretionary accrual is stationery and it does not vary and requires huge amount of data. To improve on her model, Friedlan (1994) abandoned these restrictions and came up with the modified DeAngelo (1986) model by assuming that nondiscretionary accrual is non-stationery (it is proportional to operational activity, which is a function of sales).

2.2.3.4.3 Dechow and Sloans Model (1991)

Dechow and Sloans model (1991) relaxes the assumption made by the Jones model that firms in the same industry have similar cause of nondiscretionary accruals. This model, also called industry model argues that the accruals of other firms in the same industry affect the nondiscretionary accruals of those firm-years over time. The model estimates nondiscretionary accruals thus: $NDAC_t / A_{t-1} = a + a_1$ industry median (TAC/A_{t-1}).

Where:

(TAC/A_{t-1}) = Median value of the total accruals. The yearly (a, and a_1) lagged assets for the non-sample companies in the same industry is used to measure the median.

2.2.3.4.4 Jones Model (1991)

The most popular among the numerous accrual models is the standard Jones (1991) model. This model used discretionary accruals as a measure of earnings management by decomposing accrual into discretionary and nondiscretionary. From then, other prominent researchers used discretionary accruals to measure earnings management (for example, Dechow, Sloan & Sweeney, 1995; Rangan, 1998; Teoh *et al*., 1998a; Teoh *et al*., 1998b). This model used a time series approach and split accruals into discretionary and nondiscretionary accruals, which prior studies by Healy, (1985) and Deangelo, (1986) failed to do (Spohr, 2005). Discretionary accrual is the proxy for earnings management because it represents managerial intervention in the process of financial reporting. On the other hand, nondiscretionary accrual such as business condition, excluded from the computation is beyond the control of the management. This model applied OLS regression with variation in Property, Plant and equipment (PPE) as independent variable. Jones (1991) used about 14-32 year data per firm to estimate the regression parameter to get nondiscretionary accruals during the period of the test. The model used:

$$\frac{TA_{i,t}}{A_{i,t-1}} = \beta_{0,i}\frac{1}{A_{i,t-1}} + \beta_{1,i}\frac{\Delta REV_{i,t}}{A_{i,t-1}} + \beta_{2,i}\frac{PPE_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t}$$

Where $\Delta REV_{i,t}$ is change in sales from for company *i* in year *t* and $PPE_{i,t}$ is gross Property, Plant and equipment, and $\varepsilon_{i,t}$ stands for the error term for firm i in period t.

The parameter from the model above was used in combination with data from the test period to get the discretionary accruals:

$$DAC_{i,t} = \frac{TA_{i,t}}{A_{i,t-1}} - \left[\beta_{0,i} \frac{1}{A_{i,t-1}} + \beta_{1,i} \frac{\Delta REV}{A_{i,t-1}} + \beta_{2,i} \frac{PPE_{i,t}}{A_{i,t-1}} \right].$$

One of the limitations of Jones (1991) model is the assumption that revenues are entirely nondiscretionary. The implication is that Jones model excludes portion of a managed earnings from the proxy of the discretionary accrual provided the earnings management is from discretionary revenues (Dechow *et al*., 1995). In an attempt to solve the limitation of Jones (1991) model, Dechow *et al*. (1995) introduced another model.

2.2.3.4.5 Modified Jones Model (1995)

When a variation in revenues is amended for the variation in receivables, standard Jones model becomes a modified Jones model (Dechow *et al*., 1995). This model tests the time-series of Jones models by inducing artificial earnings management. The result failed to detect more than 70% of the cases when the managed earnings are 5% of the whole assets. The result obtained almost close to 100%, type 1 error (i.e. rejection of a true null hypothesis that there is no earnings management) when the simulated earnings management surpasses 50% of assets. This model has more estimation power compared to the Jones (1991) (Dechow *et al*., 1995), especially where earnings is managed via manipulation of revenues. Their model is as follows:

$ACC_{it} = PBT_{it} - CFO_{it}$ (1)

Where: ACC = total accruals for a particular company in a particular year and industry; PBT = Profit before tax less cash flow from operating activities; i stands for industry and t stands for a year. Since the total accruals is derived from operating activities and revenue, the ordinary-least squares (OLS) cross-sectional analysis was ran to the entire firm years and industries for the estimation of the fixed values (coefficients of $\alpha 1$, $\alpha 2$, and $\alpha 3$) . Total discretionary accruals (TAC) are arrived from the residuals based on the equation thus:

$TAC/A_{it-1} = \alpha 1\ (1/A_{it-1}) + \alpha 2\ (\Delta REVit/Ait_{-1}) + \alpha 3\ (PPE_{it}/\ Ait_{-1}) + \mu_{it}$.

To calculate the nondiscretionary accruals (NDA), the modified Jones model uses the equation:

$DAit= TAC/A_{it-1} - [\alpha 1\ (1/A_{it-1}) + \alpha 2\ (\Delta REV_{it}/A_{it-1} - \Delta REC_{it}/A_{it-1}) + \alpha 3\ (PPE_{it}/\ A_{it-1})]$.

Where:

TAC_{it} = total accruals for firm i in year t.

$NDA_{i,t}$ = nondiscretionary accruals for company *i* in year *t*

A_{it-1} = lagged (one year) total assets

$\Delta REV_{i,t}$ = change in revenues for company *i* in year *t*

$\Delta AR_{i,t}$ = change in net receivables for company *i* in year *t*

$PPE_{i,t}$ = property, plant and equipment for company *i* in year *t*

$\alpha 1$, $\alpha 2$, $\alpha 3$ = industry-specific parameters

2.2.3.4.6 Dechow and Dichev's 2002 Model

This model introduced by Dechow and Dichev (2002) used working capital accruals to determine earnings management. Specifically, the model uses cash flow from operations for last year, current year and future year. The description of the mode is:

$\Delta WCC = \beta_0 CFL_{t-1} + \beta_1 CFL_t + \beta_2 CFL_{t+i} + \mu_t$

Where:

CFL_{t-1}= previous year's cash flow,

CFL_t = current year's cash flow and

CFL_{t+I} = future year cash flow.

Dechow, Hutton, Kim & Sloan (2012) criticized this model that it only measure accruals at short term disregarding the long term.

2.2.3.4.7 Performance –adjusted Accruals Model 2005

Some scholars have criticized the modified Jones model for misspecification of earnings management (Ashbaugh *et al*., 2003; Kothari, Leone & Wasley, 2005). Accordingly, Ashbaugh *et al*., 2003 recommend for the controlling for firm performance in measuring discretionary accruals. Kothari *et al*. (2005) exert that the performance of firm should be taken into cognizance in measuring discretionary accruals. They further argue that the level of misspecification shown by this model is modest in some non-random samples. The model used industry and return on assets of the previous year. It uses the following equation to measure total current accruals (TCA):

TCA = PBT + Depreciation/Amortization – CFO

Where: PBT is Profit before tax

CFO is cash flow from operating activities; scaled by the total assets at the commencement of the year.

2.2.3.4.8 Francis, Lafond, Olsson and Schipper's (2005) DAC Model

To capture abnormal accruals, this model used Modified Jones (1995) and Dechow and Dichev (2002) models together to split total and current accruals into accounting and non-accounting fundamentals. According to Francis *et al*. (2005), the quality of earning is low when the association between accruals and accounting fundamentals is low. The model used the following equation:

$$TCA = \beta_0 CFL_{t-1} + \beta_1 CFL_t + \beta_2 CFL_{t+1} + \beta_3 (\Delta REV - \Delta REC) + \beta_4 PPE_t + \mu_t$$

Where:

TCA= Total current Accruals

CFL_t = current year's cash flow and

CFL_{t+I} = future year cash flow.

CFL_{t-1}= previous year's cash flow,

$\Delta REV - \Delta REC$= Changes in Revenue less changes in receivables

PPE_t = property, plant and equipment *in* year *t*

2.2.3.4.9 Extended Modified Jones Model (2006)

Yoon, Miller and Jiraporn's (2006) introduced another model called extended modified Jones model. The model proposes that the total accruals are associated with variation in the cash revenue/sales, change of cash expenses and non-cash expenses of depreciation expenses and retirement benefits expenses. The model used the following model to calculate the total accruals:

$$TA_t/REV_t = \beta_o + \beta 1\ (\Delta REV_t - \Delta REC_t)/\ REV_t + \beta 2\ (\Delta EXP_t - \Delta PAY_t)\ /\ REV_t + \beta 3(EP_t + RET_t)\ /\ REV_t + e_t$$

Where:

ΔEXP = change in sum of cost of goods sold and selling and general administrative expenses excluding non-cash expenses.

ΔPAY = change in accounts payable

DEP = depreciation expenses

RET = retirement benefits expenses

E_t = error term

Discretionary accruals, which represent earnings management (both income increasing and income decreasing), are accruals minus non-discretionary accruals for each observation as follows:

$$DA_t = TA_t/\ REV_t - [\beta_0 + \beta_1(\Delta REV_t - \Delta REC_t)/\ REVt + \beta 2\ (\Delta EXP_t - \Delta PAY_t)\ /\ REV_t + \beta 3(DEP_t + RET_t)\ /\ REV_t]$$

2.2.3.4.10 Specific Accrual

Instead of total accruals, McNicols and Wilson (1988) used this approach to detect how managers use provision of bad debt to manage earnings. The method uses specific accruals that are industry based. For example, banks use loan loss provision to manage earnings, while insurance firms use loss reserve for that purpose. Although, this approach allows researchers to identify key factors that affect the behavior of accruals, the method is constraint to few industries. Furthermore, Sun and Rath (2010) exert that most industries apart from banks and insurance exercised discretion through different accruals instead of specific accruals. This limits the power of the specific accruals approach.

2.2.3.5 Other Methods:

2.2.3.5.1 Revenue Model

Stubben (2010) argued that accruals methods especially Jones (1991) and Dechow *et al*. (1995) misspecifed estimation of accruals. To eliminate the problem of misspecification, he exerts that managers use revenue such as receivables to manage earnings. The model measures receivable as the variation in reported revenue. The annual revenue is the variation in the revenue of first three quarters on one hand and that of the last quarter on the other hand. The equation below summarizes the revenue model:

$$\Delta ARN_{it} = a + \beta_1 \Delta Re1\_3_{it} + \beta_2 \Delta Re4_{it} + \mu_{it} \quad (1)$$

$$\Delta ARN_{it} = a + \beta_1 \Delta R_{it} + \beta_2 \Delta R_{it} * SIZE_{eit} + \beta_3 \Delta R_{it} * AGEeit + \beta_4 \Delta R_{it} * AGE_e\_SQ_{it} + \beta_5 \Delta R_{it} * AGRR\_P_{it} + \beta_6 \Delta R_{it} * AGRR\_N_{it} + \beta_7 \Delta R_{it} * AGRM_{it} + \beta_8 \Delta R_{it} AGRM\_SQ_{it} + \mu_{it} \quad (2)$$

Where:

ARN = end of fiscal year accounts receivable

R = annual revenues

Re1_3 = revenues of the first three quarters

Re4 = revenues of the fourth quarter

SIZEe = natural log of total assets at end of fiscal year

AGE_e = age of firm (years)

AGRR P = industry-median-adjusted revenue growth (0 if negative)

AGRR N = industry-median-adjusted revenue growth (0 if positive)

AGRM = industry-median-adjusted gross margin at end of fiscal year

SQ = square of variable

Δ = annual change.

2.2.3.5.2 Reversal Model 2012

This model is an extension of the modified Jones model by Dechow, Hutton and Kim (2012). The argument of this model is that previous models used in detecting earnings management including Dechow *et al*. (1995), Dechow and Dichev (2002), and Kothari *et al*. (2005) lack power of specification. The models were unable to "isolate the discretionary portion of the accrual component correctly" (Dechow *et al*. 2012, p.1). To enhance the test power and solve the misspecification problem of the previous techniques, this model exert that "any accrual based earnings management in one period must reversed in another period" (Dechow *et al*. 2012, p.1).

The model summary is:

$WCT\text{-}ACCT_{i,t} = a + bTIME_{i,t} + cTIME1_{i,t} + dTIME2_{i,t} + \Sigma fkXk_{i,t} + \mu_{i,t}$

Where:

$WCT\text{-}ACCT_{i,t}$ = non-cash working capital

TIME = 1 for dummy variable in the periods during which hypothesized determinant of earnings management is present and otherwise, 0.

TIME1 = 1 is the first year following an earnings management year and otherwise, 0.

TIME2 = 2 is the second year following an earnings management and otherwise, 0.

Xk = is the control for nondiscretionary accruals.

b = magnitude of the hypothesized earnings management.

a, μ impact of other determinants of discretionary accruals.

These models can be revised thus:

Jones Model**:** $WCT\text{-}ACCT_{i,t} = a + bTIME_{i,t} + cTIME1_{i,t} + dTIME2_{i,t} + \int\Delta REV_{i,t} + \int PPE_{i,t} + \mu_{i,t}$

Modified Jones Model: $WCT\text{-}ACCT_{i,t} = a + bTIME_{i,t} + cTIME1_{i,t} + dTIME2_{i,t} + \int(\Delta REV_{i,t} - \Delta REC_{i,t}) + \int PPE_{i,t} + \mu_{i,t}$

Dechow and Dichev's Model: $WCT\text{-}ACCT_{i,t} = a + bTIME_{i,t} + cTIME1_{i,t} + dTIME2_{i,t} + CFL_{i,t-1} + CFL_{i,t} + CFL_{i,t}+1+\mu_{i,t}$

Kothari *et al*.'s Model**:** $WCT\text{-}ACCT_{i,t} = a + bTIME_{i,t} + cTIME1_{i,t} + dTIME2_{i,t} + \int(\Delta REV_{i,t} - \Delta REC_{i,t}) + \int ROA_{i,t} + \mu_{i,t}$

Finally, despite some criticism against the Modified Jones Model that it lacks power to detect earnings management (Islam *et al*., 2011; Jiraporn *et al*., 2008, Peasnell, Pope & Young, 1999), the model is still popular. It has been used by many scholars (for example, Abdul Rahman & Ali, 2006; Ioualalen, Khemakhem & Fontain, 2015; Uddin Bhuiyan *et al*., 2013; Uweigbe *et al*., 2014). Similarly, the model has improved on the shortcomings of both total accrual methods used by Healy (1985) and DeAngelo (1986) as well as the standard Jones model (1991). Equally, this model is suitable in Nigerian situation because earnings are managed mostly in Nigeria through credit transactions (Uwuigbe *et al*., 2014). The model accurately captures earnings manipulation through credit transactions. These justify why this study uses modified Jones model. However, unlike Dechow *et al*. (1995), this study uses cash flow approach instead of the balance sheet approach to estimate total accruals prior to determining discretionary accruals. The balance sheet method was popular among researchers preceding the introduction of cash flow technique (Hribar & Collins, 2002). The cash flow approach provide more reliable, unbiased and error free estimation of discretionary accruals than the balance sheet approach (Hribar & Collins, 2002).

The balance sheet approach, which excludes non-current accruals except depreciation or amortization expenses, used the following to estimate total accruals:

$TAC_t = \Delta CA_t - \Delta CASH_t - \Delta CL_t + \Delta DCL_t - DEP_t$

Where:

CA_t = current asset changes in year t.

$\Delta CASH_t$ =cash and cash equivalent changes in year t.

ΔCL_t = current liabilities changes in year t.

ΔDCL_t = debt change included in the current liabilities in year t.

DEP_t = depreciation and amortization expenses in year t.

On the other hand, the cash flow method determines total accrual by deducting profit before tax (PBT) from cash flow from operating activities. The total accrual is estimated thus:

$TAC_t = PBT_t - CFO_t$

Where:

PBT_t = Profit before tax in year t.

CFO_t= operating cash flow in year t.

2.3 Concept, Principles and Mechanisms of Corporate Governance

"Corporate governance has been part of research into the business profession since Adam Smith's (1776) seminal publication of an inquiry into the nature and causes of the wealth of nations" (Ifeanyi, Olagunji, & Adeyanju, 2011, p.3). Berle and Means (1932) first introduced the term as it is used today. Corporate Governance was largely a field of lawyers until the 1980's (Gilson, 1996). He further mentioned that corporate governance initially involved specific rules and statutory requirements concerning meetings of the shareholders, how the directors are elected, notice requirements and the like that were mostly dissimilar to what corporations actually do. The term originated from a Latin word "gubernare" meaning to steer.

In addition, Edwards and Fischer (1994), and Shleifer and Vishny (1997) identified two main corporate governance models – bank and market-based models. They pointed the main features of bank-based such as small fractions of free float stock of large firms, low trading volumes meaning that stock markets are relatively small compared to the national economy. It has weak information disclosure to outsiders with highly concentrated ownership. The banks, companies, and families are large shareholders that exercise control over firms. The boards of directors are under the control of internal and external directors that connected to large shareholders. There is presence of dual-boards with the representatives of labor. This system is common in continental Europe and Asia.

In contrast, Shleifer and Vishny (1997) listed the features of market-based system, which include high percentage of free float firms' stock. The accounting system is very strict requiring information disclosure. Stock markets are comparatively large in relation to the national economy (liquid financial markets). The minority shareholders are protected with relative dispersed ownership of corporations, and active markets for corporate control (for example, takeovers). Single board structures excluding labor representative protect shareholders' interest. This system is popular in Anglo-Saxon countries. The market cantered, is also popular in UK and US. Nigeria adopted a market-based model from it colonial masters-the UK (Franks & Meyer, 1994). Researchers debated extensively on the superiority of each of the systems. Due to increased global competition, some scholars foresee convergence in corporate governance and structure towards the US pattern (Krenn, 2014).

The need for corporate governance in modern corporations to reassure the shareholders is necessary due to the agency problem brought by the segregation of ownership and management (Shleifer & Vishny, 1997). However, the world focused more on corporate governance at firms and country level especially after the corporate scandals, which make both international organizations, regulatory agencies, public and private firms as well as academics to turn their attention on governance matters. For example, OECD in 2004 issued principles of corporate governance with the aim of helping its member and non-member nations to improve governance structure. Furthermore, OECD (2004) noted that most discussions on corporate governance focused more on internal governance mechanisms, which depend on the legal, regulatory, and institutional environment. The International Monetary Fund (IMF) equally, requested the inclusion of governance improvements in its debt relief (Khanchel, 2007) .

Despite the agreement among international organizations, academics, practitioners and regulatory agencies on the importance and need for good governance, a widely accepted definition of the concept is scarce (Monks & Minow, 2004). They exerted that any definition of corporate governance is subjective. Despite that, Daily *et al*. (2003) from the stakeholders' perspective defined governance "as the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among the myriad participants in organizations" (p.371). Since organizations consist of numerous stakeholders both internal and external, rules and regulations should ensure that every stakeholder's interest is protected and to minimize or eliminate conflict among the parties. Similarly, from the agency theory perspective, corporate governance is defined as "a set of mechanisms through which outside investors protect themselves against expropriation by the insiders" (La Porta *et al*., 2000, p.4). This indicates that shareholders are wary of the management, which necessitates putting measures in place to safeguard their investment in the hand of the management.

2.3.1 Principles of Corporate Governance

OECD outlined five international principles of good governance with the aim of evaluating and improving institutional, legal and regulatory structure for corporate governance. Direction and recommendations are provided for all stakeholders that have a stake in the emergence of good governance. They Include:

- Rights and equitable treatment of shareholders- the shareholders should clearly know their rights and get equal treatment.
- Interest of stakeholders- firms should carry stakeholders along in policymaking.
- Duties of the board of directors- for example having experienced people on the board .The size of the board should be adequate to perform the required task.
- Integrity and ethical behavior- for example having a clear code to guide how directors conduct themselves.
- Disclosure and transparency – for example board should be accountable to shareholders through publicity of roles. There should be a system for independent verification of the company's financial reporting.

2.3.2 Corporate Governance Mechanisms

The internal corporate governance mechanisms mostly reflected in code is the focus of this study. The code encompasses rules to solve governance issues. The first major economies to issue codes of good governance are the U.S. in 1978, and the U.K. in 1992 with more than 90 countries that follow suit by 2008 (Krenn, 2014). Examples of these codes are the

Blue Ribbon Committee (BRC) 1999, and the Sarbanes-Oxely Act (U.S. Congress, 2002, Sec. 407), the Smith committee and Cadbury reports in the United Kingdom 2003, and the "Viénot 1995, 1999", Bouton 2002 reports in France.

In Nigeria, regulatory authorities follow suit by introducing corporate governance code in 2003 for public companies. The code was revised in 2011. The main regulatory authority is the Security and Exchange Commission (SEC) regulating all quoted Public Limited Companies (Plc.). However, CBN further regulates banks through over sight and additional code issued in 2006 exclusively for the banks. Similarly, all licensed pension fund operators and insurance have yet another code issued in 2008 and 2009 respectively. This means that Nigeria has a multifaceted regulatory framework on corporate governance (Idigbe, 2007) with individual sectors such as banking, insurance, pension etc. having their separate governance codes. It is pertinent to note that corporate governance code 2003 revised in 2011 issued by SEC is generic code expected to be complied with by all public companies. Other corporate governance codes are industry specific.

2.3.3 Audit Committee and its Characteristics

From the foregoing discussion, it is inferred that good corporate governance is about accountability. Corporate managers are answerable to board, while board is answerable to the shareholders. It is the duty of board to make sure that whatever the managers do is to the best interest of the shareholders. Accordingly, BRC (1999) and Center for Financial Market Integrity (CFA, 2005) advised that the board through the audit committee should institute good accounting procedures and control capable of preventing corporate fraud due to earnings management. The committee should be responsible for the supervision of external auditors in the company. The audit committee should ensure that the external auditors' priorities are in conformity with the best interests of shareholders. The committee should also ensure completeness, accuracy, reliability, verifiability, timeliness and relevance of the financial statement. The CFA (2005) further stated that audit committee should resolve all potential conflict of interest in a company in favor of the shareholders. The external auditors should be fully independent free from the management's influence with authority over the audit of the corporate group including foreign subsidiaries and associated companies.

Accordingly, this study considers the effect of foreign ownership on audit committee and external audit characteristics and earnings management in Nigeria.

2.3.4 Audit Committee Regulatory Framework in Nigeria

Historically, Nigeria's corporate governance system is market-based model borrowed from its colonial masters - the UK (Franks & Meyer, 1994). Audit committee was first introduced and made mandatory to public firms in Nigeria in 1990 by the Companies and Allied Matters Act (CAMA, 1990), being the general corporate governance law prior to the introduction of formal code of corporate governance in 2003 (Idigbe, 2007). According to Oman, Fries and Buiter (2004) and Morck and Yeung (2003) ownership structure in a country determines the type of agency problem such country faces. For example, in countries with dispersed ownership such as UK and US, agency problem is mostly between shareholders and managers. However, in developing countries identified with concentrated ownership, agency problem is mostly between controlling and minority shareholders. Nigeria has a concentrated ownership structure with agency problem mostly between controlling and minority shareholders (Sanda *et al*., 2011).

Nigeria being the most populous African country has much potential but has weak institutions and investor protection (Idigbe, 2007). A recent survey by Price Waterhouse (PwC) in 2017, Nigeria is projected to be among the 14th largest economy in the world by the year 2050, with a GDP in market exchange rate terms at $3.3 trillion. However, for the country to boost the confidence of foreign investors and protect them from expropriation of the local controlling shareholders, corporate governance mechanism including audit committee need to be strengthen (Sanda *et al*., 2011).

2.3.4.1 The Role of Corporate Affairs Commission (CAC)

CAC established by CAMA as a regulatory agency to oversee companies registered in Nigeria. The establishment of the CAC as an independent organization followed the apparent ineffective manner of which the former company registry handled the administration of companies under the repealed Companies Act of 1968. The functions of CAC (in part A) include administration of CAMA 1990, and "regulating and supervising the formation, incorporation, registration, management, and winding-up of companies" (CAMA, 1990, p.1). It is mandatory for all businesses and non-for profit organizations to register with CAC before commencing an operation. Prior to registration, companies must have article and memorandum of association. These two articles specify the structure and internal operating procedure of the company and the contractual obligation among stakeholders of that firm (CAMA, 1990).

According to the Act, it is mandatory for all those registered organizations to submit annual returns to CAC not later than 42 days after conducting general meeting (Okike, 2007). The commission also ensures compliance and stipulates punishments for non-compliance. Enforcement however seems to be weak, with lenient penalties that cannot serve as deterrent (Idigbe, 2007; Okike, 2007; Osemeke, & Adegbite, 2016). On external audit, CAMA made provision for the appointment, removal, powers, and remuneration of external auditors (357, 358, 362, and 363 in part XI). The external auditors are to report to audit committee and the committee report to the board.

Since 1990 CAMA section 359 (subsection 3 and 4) mandated every public company to establish an audit committee. It means audit committee precedes the code of corporate governance. The power to constitute the committee and ensure that it performs its duties lies with the board. The Act stipulated maximum number of six audit committee members without remuneration (Idigbe, 2007). It is the specific duty of the audit committee to indoctrinate effective corporate governance within the public companies through proper monitoring of both the external auditor and the management. It was argued that the creation of audit committee since 1990 in Nigeria is an innovation ahead of its time as no such structure exist even in US's Sarbanes-Oxley Act (Idigbe, 2007). However, despite this innovation, the corporate governance in Nigeria was labeled weak (WorldBank ROSC, 2011).

2.3.4.2 The Role of the Security and Exchange Commission (SEC)

Furthermore, another regulatory agency is the SEC established by Decree No. 71 of 1979 to regulate the Nigerian capital market. Appreciating the need to align with the international best practices, SEC in association with the CAC established a joint committee on June 15, 2000 to ascertain the flaws in the practice of corporate governance and suggest changes that are necessary to enhance it (Okike, 2007). This does not mean the companies were not observing corporate governance in practice before this period but there was no formal code in place. The companies were guided by the CAMA especially section 359 on audit committee. The two regulatory commissions approved the code called corporate governance Code in 2003. After implementing the code for five years, SEC in September 2008 inaugurated another committee for its review with the aim of strengthening the code. This led to the revised code in April 2011. This study tested level of earnings management before and after the revised code to find out whether the new code is effective.

Prior to that review, the CBN issued another code in 2006 specifically for banks and expect the banks to comply with both codes. CBN also enforces penalties for noncompliance including suspension of operating license of a bank or any financial institution. For example, In June 2009 CBN conducted a special audit of 24 banks. The exercise highlighted inadequacies in capital and liquidity ratios as well as weakness in the corporate governance of nine banks (Sanusi, 2010). As a results, the CBN sacked the chief executives and all the executive directors of eight out of the nine banks and appointed replacement (Sanusi, 2010). This shows the level of monitoring, enforcement and penalties that affect banks and other financial institutions. Although, the enforcement and penalties seem to be weak in non-financial sector, but a similar scandal in Cadbury Nigeria led to the sacking of the then chief executive and the chief financial controller of the company by the SEC. The officers were not only removed but also banned for life from holding executive position in any of the public company in Nigeria (Abdullahi *et al*., 2010; Idigbe, 2007).

2.3.4.3 The Role of Nigerian Accounting Standard Board (NASB)

Although CAMA did not mention NASB, but it is important to discuss its role in financial reporting as regards to the corporate governance and issuance of accounting standards. Prior to the establishment of CAC and SEC, the NASB established as a private sector initiative in 1982 initially domiciled at the Institute of Chartered Accountants of Nigeria (ICAN). The NASB is the body allowed by law to develop and issue accounting standards as well as Corporate Governance standards for all those that are responsible for preparing financial statements. Following the WorldBank ROSC (2011) recommendation, the Financial Reporting Council (FRCN) replaced NASB through Act No.6 2011. NASB was issuing statement of Accounting Standards (SAS) until the end of 2011 as the basis for the preparation of accounts by public companies. International Financial Reporting Standard (IFRS) replaced Statement of Accounting Standard (SAS) from January 1, 2012 in Nigeria. Idigbe (2007) argued that formal compliance with SAS (replaced by IFRS) which was the Nigerian Generally Accepted Accounting Principles (GAAP) could assist companies with good corporate governance.

Secondly, FRCN Act clearly stated that it has the power to enforce and approve enforcement with accounting, auditing, corporate governance and financial reporting standards (FRCN Act, 2011). The FRCN is therefore one of the regulatory agencies responsible for the enforcement of corporate governance apart from the issuance of accounting standards. It is not surprising FRCN made effort to introduce another National Code of Corporate Governance (NGCC, 2015) with the aim of unifying the various codes and enforce compliance. Equally, the adoption of IFRS coincides with the revision of new code. Nigerian companies were made to adhere with both (IFRS and the code), despite being monitored by two different regulatory agencies.

2.3.4.4 The Role of the Nigerian Stock Exchange (NSE)

Established by the NSE Act of 1961, NSE regulates itself and regulates the SSM. In collaboration with SEC, it also regulate the market operations (Okike, 2007). NSE provides the platform for the trading of shares on its floor. It also helps SEC monitor compliance with the statutory needs of financial reporting for all quoted companies. This is where they play an important role in corporate governance. Since NSE monitors financial reporting, they have a linkage with the audit committee who ensures the reports are not only available but also accurate, relevant, reliable and timely. However, despite supporting SEC, conflict between NSE and SEC have been reported occasionally with regards to the power over erring companies on financial reporting (WorldBank ROSC, 2004). Therefore, a revision of the existing legislation to clarify the roles, powers and limitation of the two organizations becomes necessary. WorldBank ROSC (2004) and Okike (2007) further noted poor disclosure practice and sometimes noncompliance by some companies. They noted the absence of effective machinery for monitoring and enforcement for accounting and reporting as requested by CAMA 1990.

2.3.4.5 The Role of the Nigerian Investment Promotion Commission (NIPC)

NIPC is not among the regulatory agencies that are directly involved with corporate governance in Nigeria. Their main duty is to encourage private sector investment especially foreign investment in Nigeria. It is part of NIPC mandate to attract foreign capital inflow into Nigeria. The establishment of this commission in 2004 shows the keen desire of the Nigerian government in attracting foreign investors to invest in existing companies or set up new ones. Apart from other myriad of benefits that would accrue to Nigeria through FDI and other multiplier effect, foreign investors are believed to bring in experience from their strong corporate governance countries. The more the corporate governance of the host country improves, the more it opens doors for further foreign investment (OECD, 1999).

Prior to privatization policy under the structural adjustment program (SAP) in 1988, government in Nigeria owned shares in many commercial companies (Igbuzor, 2003). Bureau of Public Enterprises (BPE) is responsible for the privatization and commercialization policy of federal government. According to the BPE, privatization is the transfer of ownership from government to private sector (both local and foreign). This became necessary due to the inefficiency, corruption and mismanagement in the public-owned companies. In Nigeria, the government abolishes restrictions on foreign investment or foreign ownership of businesses. In fact according to the Investment Promotion Commission Act, (NIPC Act, 2004), foreign investors can own 100% equity of a limited liability company in any sector with the exception of oil and gas sector. Therefore, studying effect of foreign ownership on audit committee and external audit characteristics and earnings management in Nigeria is important and justified. That would show whether the presence of foreign ownership in public companies could improve monitoring capable of curtailing earnings management.

2.3.4.6 Corporate Governance Code in Nigeria

The formal code of corporate governance came into effect in 2003 issued by the SEC as the main regulator and made compliance mandatory for all public companies. Nigeria has multiple codes of corporate governance, which include those issued by SEC, CBN, PENCOM and NAICOM. These multiple codes only help in creating confusion and dual reporting system (Okike, 2007).

The revision of corporate governance code in 2011 was necessitated following the recommendations of the world bank/IMF report (WorldBank ROSC, 2011). The report lamented how the weakness in the corporate governance including financial reporting, auditing, accounting, and of the regulatory bodies contributed to banking sector crisis in Nigeria. The banks exploited those weaknesses to engage in creative accounting to enhance their balance sheets. The extent of the costs of the crisis was between NGN1.5- NGN2 trillion (WorldBank ROSC, 2011). In addition, the country experienced corporate scandal like Cadbury and failures in banking sector in 2006 and 2009 respectively despite the existence of the code.

Another recommendation of the world bank/IMF report (WorldBank ROSC, 2011) in order to improve the weak corporate governance system and to attract FDI, was the establishment of FRCN and IFRS adoption in 2012. The argument is that IFRS has higher disclosure requirement that could lead to increase in financial reporting quality (Leuz, 2003). IFRS adoption was further argued to have strengthen the corporate governance system and lessen information asymmetry through increased level of transparency (Leuz, 2003; Pelucio-Grecco, Geron, Grecco & Lima, 2014). Information asymmetry reduces when the information gap between shareholders and management reduce. The increased disclosure of IFRS helps shareholders to know more about the internal operations of their company. With IFRS adoption, earnings management is argued to be on the low side especially with the presence of institutional investors (Musa & Kamardin, 2016).This can have a direct bearing on agency cost as the need for excessive vigilance on the management may also reduce.

One of the major differences between the 2003 and 2011 code of corporate governance is in the area of independence of the board and of the external audit. In 2011 code, the companies are required to include at least one independent director in the board. This requirement was not in the 2003 code. The revised code described a director as independent, if the director is non-executive director (NED) who is free from any affiliation with the firm. Additionally, the director must not be a substantial shareholder in the company (the shares shall not be greater than 0.1% of company's capital), a representative of a controlling shareholder, a staff or management of the firm in the previous three years preceding. Equally, the director must not be a professional adviser or major customer of the firm or its group. Furthermore, the director must not have any substantial contractual connection with the firm or its group as an associate, manager, statutory auditor, attorney, or consultant.

Furthermore, on the external auditors' independence, the revised code (2011) requires companies to disclose any non-audit services (NAS) rendered by the external auditors. Some countries allow the incumbent auditors to provide NAS, while others do not. For example, UK allowed incumbent auditors to provide NAS to their clients but with disclosure requirement on the fees paid (Beattie & Fearnley, 2010). However, the UK auditor independence framework specifies the type of NAS an audit firm can provide, but that of Nigeria did not specify. Additionally, Section 33.2 of the revised code made provision for auditors' rotation after 10 years and possible re-appointment after 7 years of disengagement. The aim is to maintain the integrity and independence of the auditors. Thirdly, another major difference between 2003 and 2011 code is on audit committee expertise. The 2011 code is explicit about the accounting or financial expertise of at least one member of the committee. This is to strengthen the committee since they are responsible for oversight function over the external auditors. This is in accordance with recommendation number three of the BRC (1999). On audit committee frequency of meeting and attendance, the 2003 code mentioned minimum number of audit committee meetings, while the 2011 stressed the disclosure of attendance by members.

Finally, to align with the international best practice the revised 2011 code proscribe CEO duality entirely, which 2003 code allowed. However, one of the weakness noticed in the revised code is silence or non-mentioning of some indicators that were in the 2003 code, for example minimum or maximum number of audit committee meeting and audit committee size. This is the reason why this study adopted most of the measurements in this study from previous studies. Table 2.1 summarizes the major differences:

Table 2.1
Major Differences between CG Codes 2003 and the Revised 2011

Item	2003	2011
Foreign Ownership	Not in the code	Not in the code
Board Gender	Not in the code	Not in the code
Board meeting	Minimum of 4 annually (1 per quarter). No maximum	Minimum of 4 annually (1 per quarter) No maximum
Audit committee size	At least 3 NEDs, No restriction on maximum	No minimum or Maximum. It depends On nature, size and uniqueness of firm
Audit committee independence	Majority of the audit committee members should be independent of the company and chair should be NED	Not in the code
Audit committee expertise	Members of the committee should be able to read and understand basic financial statements and should be cable of making valuable contributions to the committee	Members of the committee should have basic financial literacy and should be able to read financial statements. At least 1 member should have knowledge of accounting or financial mgmt.
Female director in Audit committee	Not in the code	Not in the code
Audit committee meeting	Minimum of 3 meetings annually	No restriction on the number of meetings. Disclosure of the number of meetings held during the year & the attendance of individual directors at those meetings.
Audit committee overlapping	Not in the code	No specific restriction on membership of other committees for an audit committee member
External auditors' type	Not in the code	Not in the code
External auditors' independence	Not in the code	1. Ensure disclosure of NAS and avoid conflict of interest 2. Rotation after 10 years of continuous service.

2.4 Empirical Literature on Audit Committee and Earnings Management

This section empirically discusses the association between audit committee and external audit characteristics and earnings management.

2.4.1 Audit Committee Size and Earnings Management

Most studies debated on the ideal size of the board not audit committee (for example, Abdul Rahman & Ali, 2006; Goodstein, Gautam, & Boeker, 1994; Hassan & Halbouni, 2013; Zahra & Pearce, 1989). However, the same analogy on board is to be applied on audit committee since audit committee draws its membership from the larger board (Saleh *et al*., 2007). Therefore, the major question is on ideal number of directors who supposed to sit in the audit committee. The number of directors in the audit committee is expected to be enough to work on the details reported in the financial reports and to figure out possible earnings management. Two different categories of researchers suggest different optimal sizes.

The first category suggests a small size board of directors. The argument is that boards hardly function well and are easier to CEO's manipulation remotely when members exceed seven or eight (Jensen, 1993). It was also argued that small board is more effective, ensure greater concentration and constructive debate and timely deliberation (Goodstein, Gautam & Boeker, 1994; Firstenberg & Malkiel, 1994; Jensen, 1993). On the other hand, the second category recommends larger board of directors (Pfeffer, 1972, 1973). They are of the opinion that a larger board is necessary to reduce CEO's dominance. Larger board is more likely to initiate unusual political partnerships that can dare the CEO. This means that a big board reduces CEO's excessive power to remotely dominate the board or audit committee. Additionally, large board makes it difficult for the CEO to have a control over the board in taking actions that are detriment to the shareholders. Higher quality decisions and effective supervision of the management team is possible with large board because it has many members with varied background (Singh & Harianto, 1989).

Empirically, studies have established negative association between size of board and earnings management (for example, Sáenz González & García-Meca, 2014; Saleh, Iskandar, & Rahmat, 2005). In another meta-analysis of eight studies, García-Meca and Sánchez-Ballesta (2009) found negative link between size of board and earnings management. They suggest that the size of board can improve the confidence of investors suggesting likelihood of large group ability to detect and mitigate earnings management without being remote-controlled by the management. Despite the advantage of meta-analysis in summing up the overall findings of so many researches, the sample of García-Meca and Sánchez-Ballesta (2009)'s study consist researches mostly conducted in one country- the US.

On the other hand, positive association has been proved between the size of the board and performance of the firm in a meta – analysis (Dalton, Daily, Johnson, & Ellstrand, 1999). Accordingly, Abdul Rahman and Ali (2006) empirically asserted that larger boards are inefective in their oversight function. They found positive association between board size and earnings management in Malaysia. Their study was unique because it shows that only board size among all the corporate governance variables can influence earnings management. Also consistent with agency theory, Banderlipe (2009) found a positive association between size and earnings management in the Philippines. Accordingly, similar positive association between the two variables was established in Nigeria (Okougbo & Okike (2011). They studied 62 non-financial public companies for the year 2008. However, generalization based on the findings of Okougbo and Okike (2011) is difficult considering that only one-year sample used in the research. Other studies found no relationship between audit committee size or board size and earnings management (for example, Bédard *et al*., 2004; Saleh *et al*. , 2007; Soliman & Ragab, 2014).

It is pertinent to note that the minimum or maximum of audit committee size differs across countries. For example, in UK the recommended size is three members while German corporate governance code does not mention the optimum number, though most codes recommend between 3 to 6 members (Crişan & Fülöp, 2014). In Nigeria, the code 2011 is silent on the minimum or maximum number of audit committee membership.

2.4.2 Audit Committee Independence and Earnings Management

According to Amar (2014) for several years, the ruling agencies have highlighted the significance of an independent audit committees in obtaining a more reliable financial statement. The purpose of the reports, recommendations and principles was to develop an efficient way to decrease managerial opportunism. Consequently, the majority of the ruling bodies have come up with the recommendation of setting up an independent, competent and active audit committee.

Audit committee being a subcommittee of the board is burdened with the duty of ensuring accuracy in financial reporting on behalf of the board. It is responsible for the hiring and monitoring the work of external auditors. They also ensure an effective system of internal control is instituted and serve as risk managers of the company (Crişan & Fülöp, 2014;

Sarbanes-Oxley Act, 2002). Therefore, it is assumed that a well-organized and efficient audit committee will resolve agency conflict and reduce opportunistic earnings management. Though, the efficiency of audit committee depends largely on the level of its independence (Akileng, 2014). For audit committee members to be independent, they should have no association with the firm that can impede their objectivity (BRC, 1999). Some conditions mentioned in the BRC include:

- A director who is at present an employee or former employee of the company in the last five years
- A director who accepts any form of reward from the company or of its subsidiaries apart from payment as a board member

However, empirical studies on the association between audit committee independence and earnings management document mixed results. For example, the studies by Abbott *et al*. (2004), Abdul Rahman and Ali (2006), Amar (2014), Crişan and Fülöp, (2014), Dechow *et al*. (1996), Defond and Jiambalvo (1991) , García-Meca and Sánchez-Ballesta (2009) and Fang *et al*. (2015). Others include Kent *et al*. (2006), Klein, (2002) , Lin and Hwang (2010), Osma and Noguer (2007), Piot and Janin (2007), Saleh *et al*. (2007), and Siregar and Utama (2008).

Defond and Jiambalvo (1991), Dechow *et al*. (1996) and Piot and Janin (2007), are of the view that audit committee presence alone reduces earnings management. They argue that the likelihood for firms with an audit committee to manage earnings reduces compared to those without. They emphasized the importance and relevance of audit committee presence in mitigating earnings management. Nevertheless, it was argued that mere presence of an audit committee does not automatically guarantee its effectiveness. Therefore, the attention of researchers and regulators have shifted to the independence and activities of the committees (Crişan & Fülöp, 2014).

Furthermore, Defond and Jiambalvo (1991) argued that audit independent committee is an important mechanism for controlling the likelihood of financial overstatement errors. Additionally, it was established that an independent audit committee improve financial reporting quality that can lead to lower earnings management (Al-Rassas & Kamardin, 2016). A negative association was established between independent audit committee and earnings management (Abbott *et al*., 2004; He *et al*., 2009; Kent *et al*., 2006; Saleh *et al*., 2007; Soliman & Ragab, 2014).

Accordingly, Klein (2002) used a sample of 692 public companies in the US, and examined whether independence of audit committee and earnings management are related. She found a significant negative link between independent audit committee and earnings manipulation. However, she finds no difference between companies with wholly independent audit committee and those without. Therefore, the requirement for a 100% audit committee members is somehow stringent and unnecessary. Her result was confirmed by Amar (2014). His empirical results established negative relationship between the variables but also rule out association between a wholly independent audit committee and earnings management.

Additionally, two different meta-analysis study document negative association between independent audit committee and earnings management (García-Meca & Sánchez-Ballesta, 2009; Lin & Hwang, 2010). Meta-analysis connotes the use of statistical techniques to a pool of findings from individual researches in order to integrate and evaluate their research conclusions. Use of this technique makes it plausible to arrive at more solid and reliable conclusions about a mutual research issue compared to a narrative review (Wolf, 1986). One of the limitations of meta-analysis research is inadequacy of sample. Secondly, another limitations noted in these two meta-analysis is the possibility that some of these studies discussed intersect leading to duplication.

In contrast, the role of audit committee was found to be inconsequential in preventing the prevalence of earnings management (Abdul Rahman & Ali, 2006) . They indicate that the formation of audit committee in quoted firms has not achieved its envisioned objectives. Their study provides proof that audit committee is a failure in the sense that it has not accomplish its responsibilities yet. One of the possible reasons for the trivial association between corporate governance variables and earnings management in their study is consistent with managerial hegemony theory. Unlike the agency theory, the hegemony theory exerts that board of directors are not effective in carrying out their monitoring responsibility on management. Similarly, other researchers also established no link between the existence of independent audit committee and earnings management in various countries (for example, Chee, Phua, & Yau, 2016; Osma & Noguer, 2007; Peasnell *et al*., 2005; Siregar & Utama, 2008; Waweru & Riro , 2013; Yang & Krishnan, 2005).

Similarly, an insignificant relationship between audit committee independence and earnings management was established in Nigeria (Okougbo & Okike, 2011). They asserted that the committee's effort is futile in defending shareholders interest. Limitation of their study includes inadequate samples (only 2008 data used). On the contrary, Samaila (2014) and Uadiale (2012) established significant negative relationship between audit committee independence and earnings management in Nigeria.

2.4.3 Audit Committee Expertise and Earnings Management

For the audit committee to effectively perform its monitoring role and guide the financial reporting process, its members must have cognate expertise (Bédard *et al*., 2004). They identified three types of expertise: financial expertise, governance and firm-specific expertise. While all expertise are important notwithstanding, most researchers use financial expertise to measure audit committee expertise (for example, Abbott & Raghunandan, 2003; Carcello *et al*., 2006; Chen & Liu, 2010; Dezoort & Salteerio 2001; Xie *et al*., 2003). To that effect, BRC (1999) defined expertise 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" (p.25). Similarly, Sarbanes Oxley Act advocates the presence of at least one person who is a financial expert (accounting, finance and supervisory) in audit committees and if this is not so, company should disclose reasons for noncompliance.

Thence, the U.S SEC requires compulsory inclusion of a director with financial background in the audit committee of all quoted companies. A precise disclosure for noncompliance is mandatory. The U.S SEC code of conduct for shareholders association requires that members of the audit committee to possess accounting knowledge which does not necessarily mean having a degree in accounting or being a certified Accountant. This requirement becomes necessary because external auditors depend more on audit committees if the members have financial knowledge. Likewise, in Nigeria, the revised code 2011 stipulates that members of the audit committee must possess simple knowledge in finance and should be capable to interpret financial statements. It also requires an inclusion of at least a member with accounting or financial background.

Accordingly, many empirical studies have shown that the financial literacy of audit committee members determines its effectiveness in mitigating earnings management (for example, Abbott *et al*., 2003; Abbott *et al*., 2004; Badolato *et al*., 2013, Bédard, Chtourou, & Courteau, 2004; Carcello *et al*., 2006; Chtourou & Bedard, 2001; Ioualalen et al., 2015; Kalbers, 2009). Empirical study by Mcmullen and Raghunanthan (1986) linked financial difficulty by firms with absence of financial experts in the audit committee. Equally, Carcello *et al*. (2006) using financial expertise to measure the association between audit committee and earnings management found that only 'independent' audit committee members with 'financial expertise' can effectively mitigate earnings management. However, they established no relationship between financial expertise and REM. Chtourou and Bedard (2001) advocated the inclusion of a financially literate person on the audit committee. They established negative relationship between audit committee financial expertise and earnings management. Other studies supported this finding (Saleh *et al*., 2007; Xie *et al*., 2003).

However, despite the international and local requirement for the inclusion of "financial expertise" in the audit committee, empirical study by Dezzort *et al*. (2001) suggest that an effective audit committee is the one that has qualified members with authority and the resources to protect stakeholders interest. This is possible by ensuring quality financial reporting; risk management and internal controls system are in place. This view about authority of audit committee is in line with Badolato *et al*. (2013) . They state that inclusion of financial experts notwithstanding in the audit committee is important but insufficient to mitigate earnings management. The inclusion according to them should be accompanied by an increase in relative status. The presence of financial expertise and relative status compared to the status of the management is what prevents earnings management. Therefore, when top management has higher status or exerts more authority than that of the audit committee, the management will have a field day and can manipulate earnings. Similarly, some studies established insignificant or no relationship between audit committee financial expertise and earnings management (Mishra & Malhotra, 2016; Wan Mohammad *et al*., 2016).

In Nigeria, Uadiale (2012) using a survey questionnaire found that the earnings management is low with financial expert in the audit committee. His study is however restricted to Lagos state (one of the 36 states in Nigeria) and sampled only one hundred respondents.

Interestingly, despite the importance of both financial expertise and status of audit committee, critics further pointed out that the audit committee of Enron had six members, which include four experts- an accounting professional, emeritus professor of accounting, and two top executives in other companies. All these deemed experts however failed to notice the accounting irregularities of the company (Felo, Krishnamurthy & Solieri, 2003). This suggests that audit committee members despite their financial knowledge hardly perform an independent verification, if they rely on management submissions.

2.4.4 Female Director in Audit Committee and Earnings Management

Gender diversity has been a topic of debate among psychologists and management experts in the area of cognitive functioning, leadership style, communication skills and decision making (Arun, Almahrog, & Aribi , 2015; Powell & Ansic, 1997; Schubert *et al*., 2012). This diversity could either be observable (demographic) or non-observable (cognitive) (Erhardt, Werbel, & Shrader, 2003). Psychologists and sociologists usually study non-observable gender diversity. Gender diversity is important as it allows injection of skills and ideas from different perspective because men and women usually see issues differently and may have different behavioral pattern (Mallin, 2010). Accordingly, an argument by Wood, Polek and Aiken (1985) believe that women exhibit better communication skills and outperform men in a complex group work that needs consensus. From the resource dependence theory perspective, evidence suggests that female can provide a unique resource (Daily & Dalton, 2003) and that firm may gain competitive advantages by appointing female into board (Campbell & Minguez-Vera, 2008). Women have cognitive style, innovation and creativity (Carter et al., 2003; Harrison & Klein, 2007).

In contrast, observable diversity is to do with gender, race, ethnicity or age. Example of observable diversity research are the recent corporate governance researches on the implication of female representation on boards and committees (Carter *et al*., 2010). For example, from the US perspective, board diversity means a percentage of board members who are women, African Americans, Hispanics and Asians (Carter *et al*., 2003). Therefore, a more diverse board or audit committee can influence government decisions (Terjesen, Sealy, & Singh, 2009; Terjesen, Aguilera, & Lorenz, 2015). Similarly, Peni and Vahaama (2010) put forward that women on board or audit committee can enhance financial reporting quality because of their natural conservatism, ethical behavior and risk aversion. Females are known for their low aggressiveness, less assertiveness, less overconfident, more ethical and anxious with low tendency to commit fraud (Vermeir & Van Kenhove, 2008).

Accordingly, Adams and Ferreira (2008) used large panel data in their study and found that diverse board tend to be tougher monitors that leads to lower earnings management.. They further exert that women have a substantial impact on board effectiveness because men have higher attendance problem than women. Therefore, companies with more women on boards or audit committee are likely to have frequent meetings, which can increase their monitoring role and leads to lower earnings management. Secondly, they stressed other benefits of diverse board or audit committee to include improved shareholder value, better market knowledge, increased investor confidence and employee and customer satisfaction.

Another UK research documents that having a minimum of a single female director on the board or audit committee reduces the insolvency risk, improve accountability and ensure effective communication between the board and the stakeholders (Wilson & Altanlar, 2009). Similarly, Jamali, Safieddine, and Daouk (2007) find that representation of women on board or audit committee add value to the organization and contribute to better corporate governance practice in Lebanon. In a recent study in UK, Arun and Arabi (2015) found negative association between earnings management and female directorship. These findings are similar to that of Lakhal, Aguir, Lakhal, and Malek (2015) in France, Kyaw, Olugbode, and Petracci (2015) in Europe and Luo, Xiang, & Huang, (2017) in China. Specifically on audit committee Thiruvadi and Huang (2011) established that firms with female audit committee director report lower earnings management.

On the other hand, a study in Netherland and Denmark revealed that board gender diversity has no effect on the performance of the board (Marinova, Plantenga, & Remery, 2010). The ability of women on boards or audit committee to influence shareholder value or profitability depends solely on the specific conditions of the firm not on gender (Simpson, Carter, & D'Souza, 2015). Similarly, a 525 firm-year observations research from 2003 to 2005 in the US, proved that proportion of women in an independent audit committee is not related with earnings management (Sun, Liu & Lan, 2011). Similarly, Brancato and Patterson (1999) argue that board diversity in favor of women has nothing to do with additional value but mere tokenism to reflect equality. In the same vein, Kesner (1988) citing Wall Street Journal,1987 argued that the issue of gender is for women's progress to ascend to the top of the corporate ladder, not their potential contribution.

In a conceptual study conducted in Nigeria, it was stated that attitude towards women is of typical African culture with no equal opportunities between men and women (Lincoln &

Adedoyin, 2012). They attributed the inequality to socio-traditional constraints, religion as well as unemployment that affect women more compared to men. This limits the number of women in managerial positions, on boards and in audit committees despite their likelihood of adding value to organizations. Despite continuous agitation, Nigeria is yet to enact law that would require public companies to reserve certain percentage of board positions for women.

2.4.5 Audit Committee Meeting and Earnings Management

The efficiency of the audit committee is a function of its composition (size, independence and expertise) (Dezoort, Hermanson, & Houston, 2002). Apart from these features, it is argued that the audit committee also needs to be active in order to discharge its responsibilities (Dezoort *et al*., 2002). The expectation is that the higher the annual number of audit committee meetings, the more they perform their duties and the more they monitor the management that could lead to lower earnings management. Equally, a more vibrant and active audit committee provides effective monitoring mechanism (Saleh *et al*., 2007). They established that firms with high audit committee meetings experienced lower earnings management in Malaysia. Also Xie *et al*. (2003) proved that audit committee activity might be a relevant factor in curbing down the tendency for managers to manage earnings. A negative relationship between audit committee meeting and earnings management has been established (Soliman & Ragab, 2014). They suggest that inactive audit committee is not effective in curbing down opportunistic earnings management.

Similarly, Abbott *et al*. (2004) stressed that audit committee's frequency of meeting and financial restatement have negative relationship. In a related study on board, in some Latin American countries, it is documented that frequency of board meeting increase its monitoring effectiveness on the management (Sáenz González & García-Meca, 2014). Impliedly, the frequency of audit committee meeting increases its monitoring role, which invariably reduces the likelihood of earnings management. Equally, a study showed that companies facing quarterly report restatement or facing SEC enforcement in the US are likely to have few audit committee meetings (Mcmullen & Raghunanthan, 1986). Additionally, others researchers proved that frequency of meeting by the audit committee reduces financial reporting problems (Farber, 2005; Kent & Stewart, 2008). In a recent study, it was established that not only frequent audit committee meetings that lead to lower discretionary accruals but equally the level of attendance during meetings by the members (Musa, Kamardin & Abdul Malak, 2017). They argue that companies with frequent audit committee meetings but with high absenteeism by members during meeting are likely to have high discretionary accruals.

In contrast, it was documented that no link exists between frequency of audit committee meetings and earnings management (Bédard *et al*., 2004; Jackling & Johl, 2009). To mitigate earnings management, they stressed combination of financial and governance expertise. Jensen (1993) suggests that board or audit committee should relatively be inactive because frequent meeting symbolizes financial problem by the company. In addition, Vafeas (1999) exerts that companies with frequent board or audit committee meeting have lower value in the market.

The Smith Report recommends minimum of three meetings annually, while other authors recommended four annual sittings. It is further argued that there is no hard and fast rule regarding the meeting frequency of audit committee (Stewart & Munro, 2007). They found that frequency of audit committee meeting significantly reduces apparent audit risk. The Nigeria revised code of corporate governance 2011 is silent about the minimum or maximum number of audit committee meeting.

2.4.6 Audit Committee Overlapping and Earnings Management

Kesner (1988) argued that most important board resolutions are taken within the boundaries of smaller groups or committees. This indicates that in addition to the statutory committee such as audit committee, board of directors' deem necessary to form other internal subcommittees such as risk management committee, governance or remuneration committee. It is therefore, expected that some directors may be members of more than one committee mostly referred to as overlap. In addition to committee work, most directors have full time jobs in other organizations because directors who sit on bigger boards of larger firms usually attract directorship in other companies called interlocking (Ferris, Jagannathan & Pritchard, 2003). Interlocking as a situation where a person sits on a board of more than one company (Zahra & Pearce, 1989). Although, interlocking has some advantages such as cross utilization of ideas, but it sometimes over burden the directors (Boyd, 1990). This busyness may lead to lack of concentration as directors' work on multiple boards and committees despite having a full time job.

In this direction, Ferris *et al*. (2003) developed a busyness hypothesis to describe how interlocking directors become overcommitted which hinders their performance. Surprisingly, Ferris *et al*. (2003) established no association between multiple directorship and corporate fraud. Their result also rejected the assumption of the busyness hypothesis that multiple directors shy away from committee assignments. Their findings indicate that multiple directors who are at the same time overlapping directors attend committee meetings more often than single or non-overlapping directors do. They also established that multiple directors accept position of committee chair of important committees like compensation or audit committee. Their result supported that of Fama and Jensen (1983) who earlier argued that the number of multiple directors have a favorable impact on the firm's performance. Inferably, multiple-membership of subcommittees by an audit committee member may not reduce the directors' monitoring role, but rather increase it. Equally, the effect of overlap is been debated the way that of interlock is debated. Chandar, Chang, and Zheng (2012) noted that overlapping has both advantages and disadvantages. For example, it allows knowledge sharing, which is beneficial but time consuming, which is detrimental to monitoring capacity of the audit committee. Similarly, overlap is beneficial in small-scale firms where the work of a director is less and detrimental in large companies where the work of a director is huge and requires ample time to accomplish.

It is pertinent to note that among all the subcommittees of the board, audit committee is the only statutory committee that requires presence of either specialist, knowledge of accounting standards or regulations because it deals directly with financial reporting process (Crişan & Fülöp , 2014; Méndez *et al*. 2015). In a situation where all members including the expert are members of other subcommittees, their monitoring role on the management may likely reduce due to over commitment. This can give way to opportunistic tendency by the management (Habib, Bhuiyan & Uddin, 2015). According to Allen (1992) " effective monitoring requires a commitment of time… the demand of the position, if properly understood, are inconsistent in my opinion, with the service on an impressively long list of board" (p.457). The findings of Core, Holthauson and Larcker (1999) affirmed Allen (1992)'s assertion. Although, this was in reference to interlock, but it can be applied to multiple membership of subcommittee within the same company since both requires a commitment of time.

In Nigeria, audit committee is the only statutory committee expressly recognized and mentioned by the CAMA. The corporate governance code 2011 however mentioned and allowed companies to form other subcommittees like governance/ remuneration, and risk committees (see Part B, section 9 of the revised code of governance, 2011). It also allowed the board of directors to establish any other committee considering the size and peculiarities of the company or the industry. The code stated that only directors excluding the management could be members of a committee. However, the code cautioned committee members to dedicate enough time to the work of the committee. Therefore, considering the busy nature of audit committee, the assumption is that it will be difficult for an overlapping director to dedicate adequate time in both the audit committee and other subcommittees especially the financial experts among them. Furthermore, overlapping can affect the number of meeting an audit committee can hold especially if the audit committee members are engaged in other committees' assignment. This could be more serious if the chairs of other committees are more proactive than that of the audit committee. Infrequent meeting of audit committee may also increase the possibility of earnings management due to weak monitoring (Abbott *et al*., 2004 ; Sáenz González & García-Meca, 2014; Soliman & Ragab, 2014). On the other hand, overlap is seen as beneficial because it "facilitates knowledge sharing" (Méndez *et al*., 2015, p.5), which enhance the monitoring capacity of members. They argue that the dearth of studies on the effectiveness or otherwise of audit committee overlap on earnings management lead to mixed results.

2.4.7 Audit Committee and External Audit

Audit committee and external audit are interwoven. The committee is responsible for the oversight of external audit process and financial reporting. It is an intermediary between the auditors and the board of directors (Dobija, 2015). The committee reviews the nomination of external auditors as well as the scope and results of the audit (Reid, 2015). Audit committee therefore has an important role in improving audit quality (Ittonen *et al*., 2009) . For example, the audit committee can recommend that the firm appoint a high quality auditor with reputation, can ask for increased audit effort from the auditor and can minimize the need for assurance by the external auditors by strengthening the internal audit (Abbott *et al*., 2003; Goodwin-Stewait & Kent, 2006). Audit committee can also ensure external auditors' independence by providing support to the auditors during dispute with the management (Dezoort, Hermanson, & Houston, 2003). Because of this intertwines, this study includes external auditors' type and tenure to measure audit quality and auditors' independence respectively.

2.4.7.1 External Auditors' Type

According to Watts (1977) audit services are needed to serve as a monitoring tool due to the potential conflicting interest between managers and owners including other stakeholders such as debt holders. Jensen and Meckling (1976) exert that auditing reduces agency cost and information asymmetry. Whether type of auditors has an implication on the quality of their work has been a subject of discussion among researchers (Becker *et al*., 1998; Cousins, Mitchell, Sikka, & Willmott, 1998; DeAngelo, 1981; Deis & Giroux, 1992; Krishnan, 2002; Yeoh, 2007). Therefore, "audit quality is defined to be the market-assessed joint probability that a given auditor will both (a) discover a breach in the client's accounting system, and (b) report the breach" (DeAngelo, 1981, p.186). Her study proved that audit quality is a function of auditor's size. She dismissed the argument especially by regulators like SEC that audit quality has nothing to do with the auditors' size as long as professional standards were maintained.

Francis and Wilson (1988) noted that two main ways of measuring audit quality, these are: 1) auditor size based on combines sales of all public firms audited; and 2) ordinal categorical variable on whether the firm is Big 8 or not. Earlier, DeFond and Jiambalvo (1993) used the second method. They are of the view that auditor from the Big 8 (the Big 8 became Big 6, then Big 5 and now Big 4 after successive mergers and collapse of Arthur Andersen in 2002) are more inclined to resists pressure from managers when it comes to earnings management, and more likely to produce quality audit. Similarly, Becker *et al*. (1998) empirically sampled and studied accruals based on 10,379 firm-years for Big 6 and another 2,179 firm-years for non-Big 6 and proved a positive association between abnormal accruals where the auditor is non-Big 6. They concluded that the size of the auditors determine the quality. The general assumption is that the big audit firms (referred to as Big N*)* are reputable, internationally recognized that aimed at protecting and maintaining such reputation and integrity by providing high quality audit services, which, led to lower earnings management (Francis & Wang, 2008; Francis & Yu, 2009).

Similarly, Rusmin (2010) studied auditor quality in Singapore and found out significant lower accruals in firms audited by the Big 4. In another study conducted in Taiwan in the year of IPO, a negative relation was established between auditor type and earnings management (Chen, Lin & Zhou, 2005). Additionally, Zhou and Elder (2001) used a dual measurement of auditors size and industry specialization to measure audit quality during IPO. They established a negative relationship between the Big 5 auditors and industry specialist auditors and earnings management.

Conversely, In UK for example, evidence has shown that the auditors including the so-called Big N failed to enhance corporate accountability or shareholders' protection as evidenced by increasing number of scandals (Cousins *et al*., 1998). They further cited cases of scandals such as that of the Bank of Credit and Commerce International (BCCI), Atlantic computers, Barlow Clowes, Levitt etc. They further state that poor audit quality has played a major role in job losses, savings, investments, taxation income, and pensions of innocent stakeholders. Furthermore, Piot and Janin (2005) in France empirically, found out that the Big 5 has no impact on the extent of earnings management. Similar result was established in Indonesia (Siregar & Utama, 2008). Equally, Khalil and Ozkan (2016) corroborate these findings by establishing insignificant association between Big 4 and earnings management. These cases or failure of the Big 4 auditors in detecting earnings management or fraud may be connected to the busyness hypothesis. The argument is the Big auditors are over –stretched due to many clients and targets to complete an assignment especially during audit busy season (end of calendar year) (López & Peters, 2012).

Equally, a study in Nigeria reveals that the unqualified audit reports by the so-called Big 4 at the financial year end 2008 did not hinder the four big commercial banks from distress barely six months after (Lauwo & Olatunde, 2010). For example, Deloitte (AWD) (one of the Big 4) in 2006 issued a clean bill of health to Cadbury Nigeria after which it was found that the company overstated its earnings to the tune of $85m-$100m within seven years in a row (Abdullahi *et al*., 2010). The same problem happens to Union Bank plc. The joint auditors (AWD and Baker Tilly) issued a clean bill of health to the bank but CBN found it in distress condition six month after (Sanusi, 2010). Prior to bank scandals in the year 2009 in Nigeria, WorldBank ROSC (2004) provides evidence of noncompliance with the international standards of auditing. The report further recommends the engagement of the international accounting firms in order to ensure quality. For example in paragraph 46, the report states "Auditors (mostly small & medium sized firms) prepare the same financial statements they audit due the competitive audit market and the lack of professional accountants. This fact and detail is not disclosed in the audit report or annual reports."

2.4.7.2 External Auditors' Independence

Investors use audit report as an assurance on the financial statement (Healy & Palepu, 2001). Auditing also plays a crucial role in corporate governance being an independent verification of the financial reports provided by the management (Garcia-Blandon & Argiles, 2015). To achieve these, auditors must be independent of the management who produced the report. According to the chair of the board of directors of the American Institute of Certified Accountants (AICPA) "independence is the cornerstone of the accounting profession and one of its most precious assets" (Mednick, 10). Auditors' report can only be reliable and credible if auditors are independent. The expectation is that auditor should be free from undue influence that can affect his opinion about the state of affairs of the auditee's business (Adeyemi & Akinniyi, 2011). To measure auditors' independence, many indicators were identified by researchers such non-audit service (NAS), size of auditor, and auditors' tenure (Gore, Pope, & Singh, 2001).

Firstly, on the NAS, Gore *et al*. (2011) argue that it weakens the independence of an auditor because: 1) auditors providing NAS to the same audit client, may be auditing their own work. This is because the management usually engages the auditors to prepare the accounts in the first place 2) NAS make auditors to develop interest on the management 3) NAS leads to conflict of interest on the side of the auditor. Naturally, shareholders through board are the audit client on statutory audit, while management are equally client of the auditor on NAS. Finally, Gore *et al*., (2001) document that NAS weakens auditors' independence though the level of the weakness varies with auditor's size. This means that independence of smaller auditors is more at risk when they provide NAS compared to that of Big 5 among large UK firms. This is because smaller auditors rely heavily on few clients for survival unlike the big audit firms. Accordingly, Frankel, Johnson, and Nelson (2002), supported these findings by proven a positive association between NAS and earnings management measured by discretionary accruals.

Equally, in Nigeria, Lauwo and Olatunde (2010) put it more concisely when they state that continuous commercialization of accounting as a profession and of the big four accounting firms and their reliance on NAS has clear repercussions on their independence. They document that auditors collect huge sums in NAS, which raises questions about their independence. Furthermore, Idigbe (2007) argued that provisions of CAMA are not sufficient to address the issue of auditors' independence. He further argued that auditors in Nigeria over engage in NAS such as tax, human resource and management consultancies for the firms they audit. Despite the over involvement of auditors in NAS, it is of essence to note that data about NAS is very scanty in Nigeria, as most companies do not disclose information about NAS in their financial reports in spite of the need for the disclosure by the revised code of corporate governance (2011). The dearth of data on NAS is not peculiar to Nigeria. Gore *et al*., (2001) noted that limited data in US hinders empirical study on the link between NAS and the independence of auditors despite theoretical and regulatory interest on the issue. They however maintained that the problem is now addressed in the US, as it is now compulsory to report NAS under the SEC adopted accounting series release No. 250.

However, the problem of data on NAS persists in Nigeria apparently due to absence of similar law that exist in the US and lack of enforcement. The revised code of corporate governance (2011) only recommends the need for the audit committee to review the independence of the auditors and ensure that there is no conflict of interest where NAS is provided. On the other hand, Goldman and Barlev (1974) argued differently, that purchase of NAS from the auditor increases the dependence of the firm on the auditor. This reduces the power of the management to dismiss the auditor in the event of conflict. They are of the opinion that NAS increases auditor independence by also increasing auditee dependence.

Finally, the tenure of an auditor, which is the length of time the auditor stays with a client, has been researched and debated as a threat to auditors' independence. Davis, Soo, and Trompeter (2002) studied the arguments on how tenure affects auditor independence. The augment in favor suggest that the longer an auditor stays with a client the better the auditors' understanding of the client's risk area, which lead to effective audit. However, those against argue that the longer the period, the less the auditor's ability to maintain his impartiality. A significant direct link between the tenure of auditors and earnings manipulation was established indicating that auditors are willing to sacrifice their independence for a longer audit period (Davis *et al.* , 2002; Garcia-Blandon & Argiles, 2015). Contrary result was established by Geiger and Raghunandan (2002) that auditing reporting failure is more frequent in the early years of auditor/client relationship than when the auditor stays longer with the client. This is because the auditor understands the internal operations of the client and the industry better. Tepalagul and Lin (2015) are of the view that mixed evidence on auditor independence provides an opportunity for future research.

In Nigeria, CAMA is silent about auditors' tenure or rotation (see section 357), but revised code of 2011 recommends rotation after every 10 years as a means of ensuring auditors' independence. The code provides for reengagement after seven years of disengagement. Empirical researches establish positive association between auditors' independence (measured by audit tenure) and earnings management (Okolie, 2014; Olowookere & Oladejo, 2014).

2.4.8 Foreign Ownership as Potential Moderator

This study introduces foreign ownership to moderate the association between audit committee and external audit characteristics and earnings management. A moderator could be introduced because of a weak or inconsistency in the relationship between an independent and dependent variable (Baron & Kenny, 1986). Inconsistency in findings has been established between the audit committee and external audit characteristics and earnings management. For example, inconsistent result in previous studies on the association between earnings management and audit committee independence (e.g. Amar, 2014; Siregar & Utama, 2008; Waweru & Riro, 2013) and audit committee size (for example, Aggarwal *et al*., 2011; Sáenz González & García-Meca, 2014) and audit quality (measured by the Big 4) (for example, Becker *et al*.,1998; Rusmin , 2010; Chou, Zaiats & Zhang , 2014). That justifies the introduction of the moderator.

Secondly, foreign investment is important to the survival of Nigeria's economy because it contributes 46% of the equity trading at the Nigeria stock exchange (NSE) (NSE FPI report, June 2016). Sanda et *al*. (2011) argued that to attract more foreign ownership, developing countries such as Nigeria need to improve on their corporate governance mechanism including effective audit committee. They further put forward that because of concentrated ownership structure, agency problem in Nigeria is predominantly between controlling and minority shareholders. Consequently, foreign investors need assurance against expropriation by the controlling shareholders. Therefore, both audit committee and foreign ownership could be good controlling mechanism on management that may lead to lower earnings management.

Thirdly, previous empirical a studies document significant association between foreign ownership and earnings management (Guo, Huang, Zhang & Zhou, 2015) arguing that companies with high foreign ownership report lower earnings management. Similarly, evidence showed that foreign owners are more effective in mitigating managerial opportunism, by improving the monitoring capacity of directors (Chung, Ho, & Kim, 2004; Desender *et al*., 2014). This study used a different approach from the previous studies because it explores foreign ownership as a moderating variable on the association between audit committee and AEM.

Finally, findings showed that foreign investors bring myriad of advantages to the host country in addition to capital investment. For example, it is documented that they bring along additional expertise such as information Technology (IT) and training (Ho, Wu, & Xu, 2011). Equally, Guo *et al*. (2015) argued in support of the hypothesis that knowledge spillover of foreign investors is very effective in mitigating earnings management. This hypothesis put forward that local firms could benefit from the knowledge and skills of foreign firms when the later invest in the former (Shu, Liu, Gao, & Shanley, 2014). The foreign firms especially developed countries like UK and US are seen as experienced due to their strong governance system. According to NBS, majority of foreign investment in Nigeria comes from the US, Netherlands and China. This also justifies why moderating effect of foreign ownership needs to be further explored.

2.5 Summary

The literature review reveals that the concept of earnings management is of importance to shareholders, prospective investors, regulators, standard setters and other stakeholders as well as researchers. Earnings management could either be opportunistic with the aim of deceiving the stakeholders for contractual benefits or for informative purpose, which may be beneficial to the firm including the stakeholders. The chapter reviewed various motives and measurements for managing earnings. The use of proxy became necessary because earnings management is not directly visible. The measurements include selection of accounting technique or timing, accruals and other models such as modified Jones model (1995) and ATO/PM model etc. Researchers and regulators attributed the collapse of big corporations around the world to earnings management. This necessitates the need for a solution. To mitigate earnings management, researchers empirically suggest that good corporate governance is necessary. This concept, is identified as the various mechanisms used by shareholders to protect themselves against possible expropriation by the managers who have information advantage over them. The researchers identified internal and external mechanisms. The broad focus of this research is the internal mechanisms specifically the association between audit committee and external audit characteristics and earnings management. Despite the internal corporate governance variables and the issuance of codes in countries like US and other developed countries, corporate collapse continues unabated. This casts doubt about the effectiveness of the corporate governance or audit committees in mitigating earnings management. The introduction of IFRS in 2005 in Europe aimed at having a comparable accounting standard that will benefit investors by reducing information asymmetry through mandatory disclosure. Some researchers argue that IFRS reduces the discretion of managers to use accounting method that suits them, while others argue in the contrary.

In order to strengthen the inconsistent relationship identified in the literature on the relationship between audit committee and external audit characteristics and earnings management, this study introduced foreign ownership as a moderating variable. To the best of the knowledge of the researcher, no previous study used foreign ownership as a moderator on the relationship between audit committee and external audit characteristics and earnings management. This study uses pre- and-post comparison using paired sample t-test to find the degree of earnings management before and after the revision of corporate governance code in Nigeria.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The preceding chapter discussed related empirical literature on earnings management, audit committee and external audit characteristics. This chapter discusses the underpinning theory, theoretical framework and hypotheses development. The last part of the chapter discusses research methods such as the study population, sample size, sources of data, process of data collection and variables measurement. These variables include discretionary accruals, audit committee and external audit characteristics, foreign ownership as a moderator and control variables. Also discussed are model of the study and analysis.

3.2 Underpinning Theory

Key (1999) defined the term theory "a systematic attempt to understand what is observable in the world. It creates order, and logic from observable facts that appear tumultuous and disconnected" (p.317). She further states that theory "identifies relevant variables and the connections between them in a way that testable hypotheses can be generated and empirically established" (p.317).

Consequently, several theories have been used to discuss corporate governance as a concept in relation to earnings management. Agency theory is the dominant theory used in the study and practice of corporate governance (Dalton, Daily, EllStrand & Johnson; 1998; Daily *et al*., 2003; Shleifer & Vishny, 1997). This underscores the importance of agency theory in the study of corporate governance. That does not mean other theories are less important. Agency theory is the underpinning theory in this study supported by the resource dependence theory.

3.2.1 Agency Theory

Agency relationship is said to exist when an individual (s) referred to principal (s) hire (s) another individual (s) known as agent (s), and delegates decision making authority to the agent in order to do some work on his behalf. The theory describes a contractual relationship between these parties (Jensen & Meckling, 1976). Naturally, conflict of interest arises between these two parties called agency conflict. In modern large firms, it is practically impossible for the dispersed owners (shareholders) to run their businesses directly. This necessitates the engagement of professional managers, which give the managers more access to information about the firm than the shareholders (information asymmetry) do. The separation of finance from management causes an agency problem (Fama & Jensen, 1983). For the owners to restrict managerial opportunism of the managers, they have to incur a cost known as agency cost. It is the cost which shareholders bear to inspire their agent to protect the interest of the shareholders not act in their own personal interest (Fama, 1980; Fama & Jensen, 1983). The major aim of the theory is to lessen the agency cost, which the principals incur by monitoring and controlling the actions of the agents through internal control system of the firm (Mustapa, Ghazali & Mohammad, 2014).

Furthermore, agency theory evolves along two schools of thought (1) positivist and (2) principal-agent. According to Jensen (1983) and Eisenhardt (1989), positivist agency theorists' main focus is to identify the conflict that is bound to happen between the two contracting parties and recommend governance devices that inhibit the selfish behavior of the agent. The positivist theorists argued that the board of directors is the most important and powerful tool available to stockholders in a large corporations to monitor and inhibit opportunism of the management (Fama & Jensen, 1983). Secondly, positivist researchers argued that positivist-agency theory is the leading theory in corporate governance research especially in the U.S. Corporate governance research has mostly rotated around conflicting interest between principal and agent (Chhaochharia & Laeven, 2008; Daily *et al*., 2003; Morrison, 2004). Finally, the positive agency theory exclusively focused on the owner-manager conflict. The agency problems in Nigeria are mostly between controlling and minority shareholders (Sanda et *al*., 2011).

Comparatively, the principal-agent theorists focused on the general idea of principal-agent association for example, employer-employee, attorney-client or supplier-customer relationship etc. (Harris & Raviv, 1978). It was argued that the principal-agent theory has a wider focus and greater interest in general, theoretical implications (Eisenhartdt, 1989). She further argued that the two schools of thought are complementary rather than opposing. Most good corporate governance mechanisms and regulations advocated by this theory are reflected in codes (Daily *et al*., 2003). These include codes recommending adoption of audit committees and its characteristics, choice of auditor and their independence. The aim of these codes is to ensure fairness and prevent negative effects of self-centered top managers.

Finally, this study chooses agency theory because of its popularity and simplicity in governance research. It simply reduced large corporations into only two participants namely the stockholders and the managers with a clear and consistent interest for each participant (Daily *et al*., 2003). They are of the view that other theories came up as a compliment rather than a substitute to agency theory in order to have multi-theoretical approach to corporate governance, which enhance the understanding of the concept. Despite the popularity of the agency theory, it received heavy criticism that it addresses no clear problem and it is a one-sided theory. Similarly, the theory is hardly subjected to empirical test as it seldom tries to explain actual event (Perrow, 1986). The criticism does not in any way reduce the popularity of the theory.

3.2.2 Resource Dependence Theory (*RDT*)

Another supporting and connected theory is the *RDT* proposed by Pfeffer and Salancik (1978). This theory has been used to describe "how organizations decrease environmental interdependence and uncertainty" (Hillman *et al*., 2009) . Accordingly, organizations are parts of the environment and the environment provides the critical needs for the organizations. The level of "criticality" depends on whether or not the organization can continue to survive in the absence of the scarce resources provided by the environment (Pfeffer & Salancik, 1978) . *RDT* assumes that organization attempts to reduce the level of uncertainty or avoid it completely (Werner, 2008). *RDT* further assumes existence of dependency between actors who have resources which is usually scarce and the actors who need those scarce resources (Pfeffer & Salancik, 1978). However, the level of dependency is contingent on the extent of present resources available to organization. If one organization exists with huge reservoir of resources, the dependency tends to reduce and vice versa.

Furthermore, RDT argues that whoever controls resources has power over the actors who need those resources (Werner, 2008). It is assumed that those actors want to reduce such dependence (invariably increase their own power). *RDT* was developed initially to provide a different viewpoint to economic theories of mergers and interlocks. However, right from inception the theory also focused on organizational decision such as the ideal persons to appoint into boards of directors (Pfeffer & Salancik, 1978). Additionally, *RDT* suggested inclusion of external directors on the board because of the benefits firm derives from their inclusion. The benefits include: a) serve as a source of free or cheap advice to the management b) sources of information and link to outside environment c) access to resources such as legitimacy, expertise and experience (Pfeffer & Salancik, 1978). Also supporting this, Stearns and Mizruchi (1993) argued that firm could secure a favorable loan if board includes combination of external directors who are top managers of financial firms like banks. Equally, outside directors who are executives or associates in a law firm for example, may offer legal counsel in a meeting or during private conversation with the company's management that may be ordinarily be costly for the company to get. This necessitates enlarging the board of directors to incorporate enough people that would bring such benefits to the company.

Accordingly, Pfeffer (1972b) found relationship between board size and environmental requirements of firms and conclude that the more the firm depends on the environment (interdependence), the more it needs huge outside directors. Dalton et al. (1998) confirmed this assertion in a meta-analyses. Although, *RDT* made specific reference to board size and suggested larger board, the theory by extension could be applied to audit committee size. Hence, it is better if audit committee whose size is big enough to accommodate diverse members from the environment that can provide 'critical resources'. They can also advise both the board and the management on financial reporting, auditing, and internal control system, and monitoring capable of subverting earnings management. Xie *et al*. (2003) empirically argue that large board is more likely to have independent directors with financial experience, which makes it more effective in reducing earnings management.

Finally, Pfeffer and Salancik (1978) argue that companies in highly controlled sectors require many external directors with requisite skills. Equally, this can apply to audit committee level of expertise. For example, firm can co-opt and attract experienced financial experts such as accountants, auditors, or CEOs in other big organizations or partners in an audit firms to serve in their audit committee in order to make professional contribution that can reduce earning management. Mizruchi and Stearns (1988) empirically provide support in this direction using sample data of 22 large US industrial corporations that appoint directors from the financial institutions. Audit committee being a specialized committee also ought to have members that are professionals with requisite expertise.

Interestingly, instead of supporting one theoretical approach, Hillman *et al*. (2009) are of the view that combing both the agency theory and *RDT* in explaining the functions of board is important. Agency theory emphasized monitoring of managers as the most important role of board, *RDT* emphasized provision of resources. Hillman *et al*. (2009) are of the view that both are important. They asserted that individually, each theory's viewpoint of the role of board is incomplete. The agency theory over emphasized monitoring and excludes the capacity to monitor, which is the focus of *RDT*. Furthermore, Hillman *et al*. (2009) suggested combining *RDT* with other salient theories. They are of the view that *RDT* is known for a long time to have been used jointly with other theories to study a particular phenomenon of interest.

Accordingly, this study explores this advantage in applying *RDT* and agency theory in studying the impact of foreign ownership on audit committee and earnings management. *RDT* recognizes the impact of external factors and inter organizational relationship such as the influence of foreign ownership on the affairs of a company, and the benefits in form of expertise and experience firm can derive from such relationship. Similarly, agency theory emphasized need for monitoring. The skills of the foreign investors could be a monitoring mechanism that could lead to lower earnings management. In addition, Guo *et al*. (2015) argue from the viewpoint of the knowledge spillover hypothesis to buttress that the skills of the foreign investors on corporate governance issues can help in reducing earnings management practice. Knowledge spillover hypothesis originates from the field of entrepreneurship in a book titled ‘‘Innovation and Industry Evolution’’ authored by Audretsch in 1985. The main idea of the hypothesis is that knowledge spills over from its origin and leveraged by prospective entrepreneurs to create a new venture (Ghio, Guerini, Lehmann, & Rossi-Lamastra, 2015). Guo *et al*. (2015) posit that the knowledge of foreign investors in their strong governance countries (developed economies with strong institutions) would spill over to the host countries (developing economies with weak institutions) where they invest thereby lessening earnings management in the host country.

Table 3.1 summarizes how each of the independent variable is discussed vis-à-vis the relevant theory:

Table 3.1
Independent Variables and Relevant Underpinning Theory

Theory	Variables
Agency Theory	1) Audit Committee Independence
	2) Audit Committee Meeting (non-directional)
	3) Audit Committee Overlapping (non-directional)
	4) External Auditors' Type (non-directional)
	5) External Auditors' Independence
RDT & Agency	1) Audit committee Size (non-directional)
	2) Foreign Ownership
RDT	1) Audit committee Expertise
	2) Female Director in Audit committee (non-directional)

3.3 Theoretical Framework

Figure 3.1 below presents the theoretical framework of the study. It depicts the association between the independent variables (IVs), moderating variable (MV) and the dependent variables (DV).

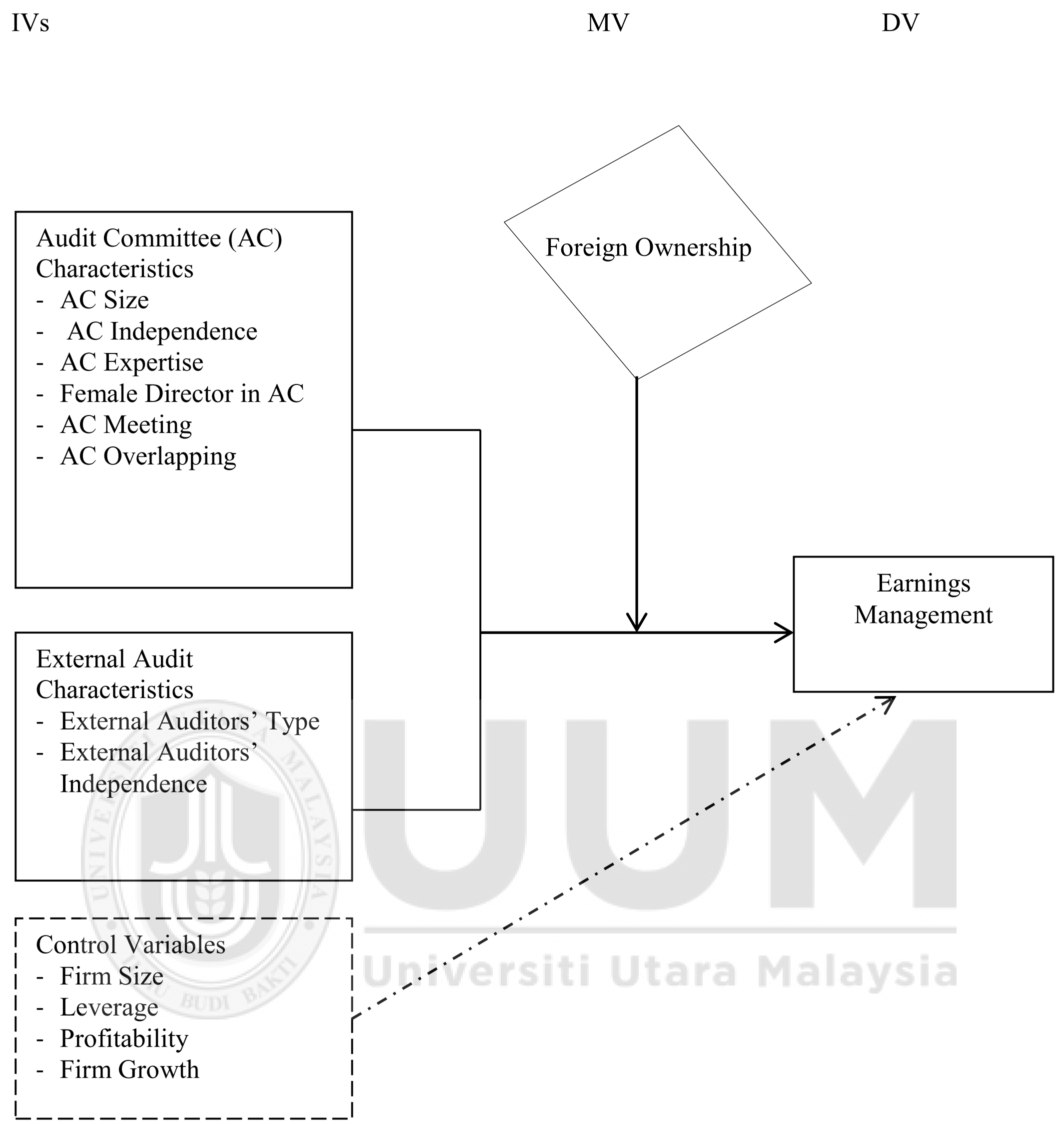

Figure 3.1
Theoretical Framework

This study adopts multi-theoretical approach using the agency and *RDT* to understand the association between audit committee characteristics and earnings management moderated by foreign ownership as depicted in figure 3.1.

Though the agency theory was described as the leading theory in both corporate governance and earnings management but other theories are also relevant (Daily *et al*., 2003). The agency theory postulates board independence and the board delegates this oversight function to the audit committee. Therefore, the ability to perform this monitoring role is improved as the independence of the audit committee increases (Saleh *et al*., 2007) . The monitoring role of audit committee becomes more effective if the committee comprises of more independent and non-executive directors (Fama, 1980). It is assumed that audit committee with majority of independent directors are more credible and impartial, hence their ability to monitor the process of financial reporting with high chance of reducing of earnings management.

Similarly, audit committee level of activity (frequency of audit committee meetings within a year to be used as measurement), can be explained from the agency theory viewpoint (Vafeas, 1999) . To enhance the monitoring ability of the audit committee, the expectation is that the more active the committee is, the higher its level of effectiveness. Abbott *et al*. (2003) prescribed that only active audit committee can perform the oversight function of monitoring of the management against expropriation of shareholders. Menon and Williams (1994) argued that audit committee with few or no meeting at all is less likely to be an effective monitor. An active board is crucial to backstop for external auditors as they attempt to protect corporate integrity and financial disclosure (Ferris, *et al*., 2003). They further argued that an under supervised management may be tempted to manage earnings. Agency theory can also explain the audit committee overlapping. Overlapping reduces the frequency of audit committee meetings or attendance by the overlapping members. This invariably decreases the monitoring capacity of the audit committee. Therefore, mangers who want to get chance to manage earnings prefer to have overlapping audit committee members.

In addition, agency theory explains the role of audit quality and the auditors' independence in mitigating earnings management. Auditing is a means of lessening agency cost (Jensen & Meckling, 1976). Therefore, when agency cost is higher, the demand for high quality audit increases (Francis & Wilson, 1988). Audit quality is one that is credible, competent, and reliable. Some researchers assumed that these qualities are found only when the audit firm is prominent and of international standard referred to as big 4 or 5 (Gore *et al*., 2001). The bigger firms are considered to have experienced personnel, resources and can resist management pressure (Gore *et al*., 2001). Finally, agency theory explains foreign ownership because foreign investors are wary about their investment especially in emerging economies. They are afraid about investing in countries and companies that have weak corporate governance system because they doubt the credibility of the managers (Mangena & Tauringana, 2007).

Equally*, RDT* has been used to explain some audit committee characteristics in association with earnings management (Dalton *et al*., 1999; Saleh *et al*., 2007; Ocasio,1994). The critical resources needed by organizations could be in form of expertise and experience. Audit committee being a specialized committee that supervised financial reporting process and professional work of auditors requires financial experts in its membership. These experts could be sourced from the environment by appointing financial gurus that are financial controllers in other firms into the audit committee. This would help to not only meet regulatory requirement but also help in ensuring that they understand what both the external auditors and the management are doing. It equally decreases the chance of fraud and earnings management (Xie *et al*., 2003).

Furthermore, *RDT* further stipulates that larger board that coopt diverse professionals from the environment that can provide the critical resources (experience and expertise) needed by the firm that can enhance the capacity of audit committee to monitor the management (Mizruchi & Stearns, 1988; Zahra & Pearce, 1992).While the RDT emphasized the experience and expertise, agency theory focuses on monitoring. Both are important in curbing earnings management. Ocasio (1994) exerts that a bigger board has more propensity to initiate ideas and cohesion that can dare the CEO than a smaller one. Jensen (1993) advocates for small size board. He states, "Keeping boards small can help improve their performance. When boards get beyond seven or eight people they are less likely to function effectively and are easier for the CEO to control" (p.47). The RDT and agency theory are applied to explain the association between audit committee size and earnings management.

Finally, diversity has been advocated by the RDT. The theory (RDT) opines that a diverse (including gender diversity) board or audit committee is the one whose members have various features capable of enhancing performance (Şener,Varoğlu & Aren, 2011). It is argued that inclusion of female in board or audit committee will lead to effective monitoring of managerial activities (Adams & Ferreira, 2009). This is because female are seen to be more ethical, have better communication skills, averse to risk, and thoughtful than men (Martin, 1990; Schubert *et al*., 2012; Thiruvadi & Huang, 2011). Female director in audit committee can bring these qualities to bear in the activities of audit committee.

3.4 Hypotheses Development

This study has eight independent variables, which are audit committee size, audit committee independence, audit committee financial expertise, female director in audit committee, audit committee meeting, audit committee overlapping, external auditors' type and external auditors' independence. Earnings management is the dependent variables. The study also has foreign ownership as moderating variable. This study formulates sixteen hypotheses for testing from the perspective of agency theory and *RDT*.

3.4.1 Audit Committee Size and Earnings Management

Resource dependence theory posits that big size audit committee means the members can bring more resources to the company, such as experience and expertise, which contribute to the audit committee's success in monitoring management. Agency theory emphasized good monitoring of the management to ensure that they act in the best interest of their principals. Some advocates of *RDT* opined that the more firm needs effective external linkage, the bigger its board should be (Ocasio, 1994; Pfeffer, 1972; Pfeffer, 1973; Pfeffer & Salancik, 1978).

Empirically, negative relationship was established between audit committee and earnings management (Fodio, Ibikunle & Oba., 2013; García-Meca & Sánchez-Ballesta, 2009; Juhmani, 2017; Kim, Segal, Segal, & Zang, 2016; Saleh *et al*., 2005; Zahra & Pearce, 1992). In contrast, other studies document positive association between audit committee size and earnings management (Bandalipe, 2009; Okougbo & Okike, 2011). While others established insignificant association between the two variables (for example, Susanto & Pradipta, 2016).

Based on the RDT and agency theory, and the empirical studies, non-directional hypothesis is formulated:

Hypothesis 1: There is a significant association between audit committee size (ACSIZE) and earnings management (EM) in Nigeria.

3.4.2 Audit Committee Independence and Earnings Management

The agency theory by Jensen and Meckling (1976) is the leading theory in both corporate governance and earnings management (Daily *et al*., 2003). The theory used contract metaphorically to explain the relationship between principal and agent. The relationship emanates due to the split between control and ownership typical of large modern corporations which necessitate engagement of professional managers (Fama & Jensen, 1983). The theory postulates that agents are selfish and attempt to maximize their personal benefit at the stockholders' expense (Jensen & Meckling, 1976). To protect their interest, shareholders must effectively monitor the management at least to minimize their opportunistic tendency through independent board of directors (Jensen & Meckling, 1976). Since the board delegates this oversight function to the audit committee, the ability to perform this monitoring role is improved as the independence of the committee increases (Saleh *et al*., 2007). The monitoring role of audit committee becomes more effective if the committee comprises of more independent and non-executive directors (Fama, 1980). It is assumed that independent directors are more credible and impartial, hence their ability to monitor financial reporting process and reduce possibility of earnings management.

Accordingly, the Centre for Financial Market integrity (CFA, 2005), corroborating the importance of the independence of board members (including audit committee) from agency theory perspective, opined that the directors should be impartial. They should not be under the control of the management of the company or other groups who exert control over management. An independent board (or audit committee) may be more likely to make decisions that fairly or properly benefit the interests of the shareholders. Their decisions may unfairly benefit the management when the independence of the board (audit committee) is compromised.

Empirical studies found that audit committee existence and its independence curb earnings management (Abbot *et al*., 2006; Amar, 2014; Bhasin, 2016; Crişan & Fülöp, 2014; Dechow *et al*., 1996; García-Meca & Sánchez-Ballesta, 2009; He *et al*., 2009; Kent *et al*, 2006; Kim *et al*., 2016; Klein, 2002; Lin & Hwang, 2010; Pathak, Karim, Suh & Ziwen, 2014; Saleh *et al*., 2007; Soliman & Ragab, 2014; Xie *et al*., 2003). Based on the theory and empirical literature on the link between audit committee independence and earnings management, a hypothesis is formulated thus:

Hypothesis 2: There is significant negative association between audit committee independence (ACIND) and earnings management (EM) in Nigeria

3.4.3 Audit Committee Expertise and Earnings Management

RDT has been used to explain some audit committee characteristics in association with earnings management (Dalton *et al*., 1999; Saleh *et al*., 2007; Ocasio,1994). The theory posits that firm depends on the external environment to provide its critical resources (Pfeffer & Salancik, 1978). The critical resources could be in form of expertise and experience. Audit committee being a specialized committee that supervised financial reporting process and professional work of auditors requires financial experts in its membership. These experts can be sourced from the environment by appointing financial specialists that are financial controllers in other firms into the audit committee. This helps not only meet regulatory requirement but also ensure high quality financial reporting. The likelihood of fraud and earnings management reduces when audit committee has financial experts (Xie *et al*., 2003). This is because the financial experts can understand earnings management and can act to suppress it.

Empirical evidence showed that companies with audit committee members that are financial experts have smaller discretionary accruals (Badolato *et al*., 2013; Bédard *et al*., 2004; Garcia-Sanchez, Martinez Ferrero, & García-Meca, 2017; Ioualalen, *et al*., 2015; Juhmani, 2017; Krishnamoorthy & Maletta, 2016; Xie *et al*., 2003). These theoretic and empirical reasons led to the formulation of the hypothesis thus:

Hypothesis 3: There is a significant negative association between audit committee financial expertise (ACEXPERT) and earnings management (EM) in Nigeria.

3.4.4 Female Director in Audit Committee and Earnings Management

A diverse audit committee is the one with representation of both male and female. RDT advocates inclusion of experts and experienced directors with various features into board or audit committee, which can be sourced from the external environment (Pfeffer & Salancik, 1978; Sener et al., 2011). Adams and Ferreira (2009) argue that female directors have unique skills that can have positive impact on firms, hence the need for a diverse board or audit committee. Gul et *al*. (2011) posit that gender diversity can affect quality of audit committee decisions, which can affect level of earnings management. Some studies have shown that women are less prone to crime, have good communication skills, are not risk takers, are more restrained, diligent and at same time of ethical behavior than men (Martin, 1990; Schubert *et al*., 2012; Thiruvadi & Huang, 2011). Therefore, female director in audit committee with these qualities can support the audit committee to monitor the management well. Empirically, Carter *et al*. (2003) proved positive link between presence of female directors and firm value. Accordingly, Erhardt *et al*. (2003) also established positive association between board diversity and financial achievement of firms.

Furthermore, Arun *et al*. (2015) and Thiruvadi and Huang (2011) found empirical evidence that involvement of women in audit committee reduces earnings management. They argue that public confidence increases due to the presence of women on board or audit committee. The argument that women are more cautious than men would reduce their tendency to allow earnings management to thrive. Since they are risk averse and less adventurous than men, they may not want to take the risk in the event of possible litigation. Shrader, Blackburn, and Iles (1997) found a significant negative relationship between the proportion of female directors and profitability indicating that firms with high number of female directors report higher profit. They are of the view that women have better managerial skills compared to men. In the same vein, sampling top 100 top US companies based on revenue, Catalyst (1995) reported 97 of those companies had female board member. Similarly, Burgess and Tharenou (2002) stressed the desirability of including women in the board. Specifically, on earnings management, empirical studies show negative link between presence of female in audit committees and earnings management (Arun *et al*., 2015; Garcia-Sanchez et al., 2017; Kyaw *et al*., 2015; Lakhal *et al*., 2015; Luo *et al*.,2017; Musa, Kamardin, & Abdul Malak, 2016; Thiruvadi & Huang , 2011).

On the contrary, other researchers put forward that diversity in board in favor of women is mere courtesy or token to the women not necessarily additional value and does not mitigate earnings management (Brancato & Patterson, 1999; Sun *et a*l., 2011). Likewise, Kesner (1988) citing Wall Street Journal,1987 exercised doubt that women have a distinct contribution to make in form of quality in board or in audit committee. This indicates lack of consensus that female director in audit committee can mitigate earnings management.

Based on the theory and empirical proof, a non-directional hypothesis is formulated:

Hypothesis 4: There is a significant association between female director in audit committee (FEMDIRECT) and earnings management (EM) in Nigeria.

3.4.5 Audit Committee Meeting and Earnings Management

Frequency of board or audit committee meeting is associated with governance in line with the agency theory (Vafeas,1999). To some researchers, the more external auditors are engaged by the audit committee through frequent meetings, the more issues come out with the high possibility of detecting and mitigating earnings management (Abbott *et al*., 2003). It is argued that frequency of audit committee meeting enhances the monitoring role of the committee over management (Li, Mangena, & Pike, 2012). It also reduces the chances of collaboration between external auditors and the management (Sáenz González & García-Meca, 2014; Saleh *et al*., 2007). CFA (2005), further points that frequent audit committee meeting allows the committee to extensively review the work of external auditors at every stage of the audit excersise and resolve any conflict between auditors and management at its early stage.

Accordingly, Abbott, and Parker (2000) established relationship between audit committee frequency of meeting and auditor selection for members to avoid reputational losses in the case of fraud or earnings management. They also found out that audit committee that meets twice annually at a minimum are unlikely to be found guilty for fraud. Equally, empirical studies established that audit committee with few or no meeting; hardly conduct an effective monitoring (Menon & Williams, 1994). They further asserted that even if audit committee is independent, it is unlikely to be efficient unless it is active measured by frequency of meeting. Likewise, Xie *et al*. (2003) argued and established that frequent audit committee meeting is associated with lesser discretionary accruals. Other researchers (for example, Farber, 2005; Garven, 2015; Ioualalen *et al*., 2015; Kent & Stewart, 2008; Saleh *et al*., 2007; Musa *et al*., 2017; Stewart & Munro, 2007) proved similar results.

A contrasting view professed by another leading proponent of agency theory, Jensen (1993) is that board or audit committees' expend much time on routine tasks, which limit the chances for outside directors to exert significant control over management. Jensen (1993) further recommends that board or audit committee should relatively be inactive. He added that frequent board or audit committee meeting is a sign of poor performance or problem. Empirically, Vafeas (1999) established that market attach less value to companies whose board or audit committee meets frequently. The market assumes that those companies are facing difficulties including the possibility of financial reporting problems. In addition, another study established no association between board or audit committee meeting and performance (Jackling & Johl, 2009).

In view of the agency theory and conflicting evidences, a non-directional hypothesis is formulated:

Hypothesis 5: There is a significant association between audit committee meeting (ACMEET) and earnings management (EM) in Nigeria.

3.4.6 Audit Committee Overlapping and Earnings Management

Agency theory emphasized effective monitoring of the management to reduce their opportunistic tendency. This monitoring is only possible when board or audit committee members have enough time to do the monitoring. For audit committee members that are members of other board committee may face time constrain to effectively monitor management. Eisenhardt (1989) argued that audit committees members with multiple directorships or board committee membership might face time limitations, which may adversely disturb their managerial monitoring. Overlapping just like interlocking over commit the audit committee members or directors making them incapable of providing meaningful managerial monitoring (Core *et al*., 1999; Shivdasani & Yermack, 1999). Ferris et *al*. (2003) advanced busy hypothesis arguing that directors holding more outside board seats have a limited time to spend serving on board committees. Jirapon, Singh & Lee (2009) applied the same hypothesis to explain audit director busyness on board committees.

Empirically, Méndez *et al*. (2015) argued that there is dearth of studies on audit committee overlapping. Most prior studies were on board interlock. For example, Beasley (1996) found positive association between multiple directorship and financial statement fraud. Similarly, negative relationship between multiple directorship and financial reporting quality (FRQ) has been established (Jubb, 2000; Davison, Stening, & Wai, (2004). As quality of financial report diminish, the possibility of earnings management increases. Some studies were specific on audit committee overlapping not interlocking. For example, Core *et al*. (1999) established positive link between multiple membership (overlapping) of audit committee members and earnings management. Similarly, Liao and Hsu (2013) established weak corporate governance culture in firms with overlapping directors especially between audit committee and compensation committee. Tanyi and Smith (2014) proved the busyness hypotheses by establishing a positive link between firm with busy audit committee chair or audit committee financial expert and abnormal accruals.

On the other hand, it was established that overlapping audit committee members' contributions during meetings are superior due to their vast knowledge gained from other board committees. That enhances their monitoring capacity and their ability effectively monitor management (Chandar *et al*., 2012). Similarly, Méndez *et al*. (2015) established a negative association between overlap and earnings management only in small companies where the workload is low. However, in large firms with high workload, overlapping could increase earnings management. Another argument is that audit committee overlapping reduces earnings management if the overlapping members are female due to their high-level commitment to duties (Musa *et al*., 2016). In view of the conflicting argument, this study hypothesizes a non-directional significant association between the two variables:

Hypothesis 6: There is a significant association between audit committee overlapping (ACOL) and earnings management (EM) in Nigeria

3.4.7 External Auditor's Type and Earnings Management

Audit quality and the auditors' independence in mitigating earnings management can be explained from the perspective of agency theory. Auditing is a means of lessening agency cost (Jensen & Meckling, 1976). Therefore, when agency cost is higher, the demand for high quality audit increases (Francis & Wilson, 1988). It was established that audit quality is a function of auditor's size (DeAngelo, 1981). Gore *et al*. (2001) argues that only international audit firms referred to as Big 4 can provide such quality audit. They further argued that the bigger firms are considered more independent with ability to resist management pressure. Accordingly, extant studies report a negative and significant relationship between audit quality measured by the Big 4 and earnings management (Becker *et al*., 1998; Chen *et al*., 2005; Garven & Taylor, 2015; Houqe, Ahmed, & Zijl, 2017; Rusmin, 2010; Teoh *et al*., 1998; Zhou & Elder, 2001).

Another argument is that size of auditor including the Big 4 does not guarantee audit quality (Cousin *et al*., 1998). Many at times, the Big 4 are busy and over stretched due to rush for their services, which reduces the quality of services they provide. This increases the possibility for earnings management. This argument of auditor busyness is consistent with the findings of López and Peters (2012) that audit busy season (end of calendar year) and the workload of the auditor lessen audit quality and increase earnings management. In view of these contradictory arguments, a non-directional hypothesis is formulated:

Hypothesis 7: There is a significant association between external auditors' type (EAT) and earnings management (EM) in Nigeria

3.4.8 External Auditors' Independence and Earnings Management

Agency theory advocates the need for an independent external auditor to verify the accounting numbers prepared and submitted by the management (Wallace, 1980). Auditors have a vital role to play in the process of financial reporting and are capable of mitigating earnings management. Healy and Palepu (2001) postulate that investors get assurance from the auditors on whether the financial statement presented by firm confirms to GAAP (now IFRS) or not. Auditors can only play this monitoring role if they are independent of the management of the firm they audit. Researchers used various indicators to measure external auditors' independence. Some of the measurements used include NAS (for example, Ashbaugh *et al*., 2003; Frankel *et al*., 2002; Goldman & Barlev,1974; Gore *et al*., 2001; Lauwo & Olatunde, 2010). Others used size of auditor to measure its independence (for example, Gore *et al*., 2001).While a number of studies used tenure or length of time an auditor stays with a particular client to measure independence (for example, Geiger & Raghunandan, 2002; Garcia-Blandon & Argiles, 2015; Okolie, 2014; Olowookere & Oladejo, 2014).

Empirically, positive association was established between audit tenure and external auditors' independence (Garcia-Blandon & Argiles, 2015; Okolie, 2014; Olowookere & Oladejo, 2014).This study also used audit tenure to measure auditors' independence because of non-availability of data on NAS. Most companies in Nigeria do not disclose information about NAS in their financial reports despite the need to do so by the corporate governance code. This study used audit tenure of three years to measure external auditors' independence (EAIND) with the assumption that if auditor stays more than three years with a client might not be independent. The study expects positive association between audit tenure and earnings management. Based on the discussed theory and empirical proofs, a hypothesis is developed thus:

Hypothesis 8: There is a significant positive association between external auditors' independence (EAIND) and earnings management (EM) in Nigeria.

3.4.9 Moderating Effect of Foreign Ownership on the Association between Audit Committee Size and Earnings Management

Extant studies have reported different results on the association between audit committee size and earnings management. Vafeas (2005) argues that the effectiveness of an audit committee depends largely on the size of the committee. Some researchers argue that the bigger the size of the audit committee, the higher its performance and its ability to mitigate earnings management. On the other hand, Abdul Rahman and Ali (2006) are of the opinion that few members in the audit committee strengthen the monitoring capacity of the audit committee, which reduce earnings management. Furthermore, significant negative association between audit committee size and earnings management have been reported (Fodio *et al*., 2013; Mishra & Malhotra, 2016). However, Felo, Krishnamurthy and Solieri (2003) established significant positive association between the two variables. While others such as Soliman and Ragab (2014) establish insignificant association between the two variables.

In addition, empirical studies established a relationship between foreign ownership and earnings management. For example, Chung *et al*. (2004), Guo *et al*. (2015) and Kukah, Amidu and Abor (2016) reported that companies with substantial foreign ownership engage less in earnings management. However, no study documents the interaction effect of foreign ownership on the association between audit committee size and discretionary accruals. The foreign ownership in a company is projected to moderate the association between audit committee size and discretionary accruals because foreign owners increase the monitoring capacity in a company (Grinblatt, & Keloharju, 2000). The foreign owners in a company therefore ensure that an optimal size of audit committee is in place that will effectively monitor the management in order to mitigate earnings management. Therefore, this study hypothesizes that:

Hypothesis 9: Foreign ownership (FO) significantly moderates the association between audit committee Size (ACSIZE) and Earnings Management (EM) in Nigeria

3.4.10 Moderating Effect of Foreign Ownership on the Association between Audit Committee Independence and Earnings Management

Researchers have extensively debated on the association between audit committee independence and earnings management and established mixed findings. The Sarbanes-Oxley Act (2002) demands that companies should reveal whether at least one independent director is included in their audit committee. The possibility of managing earnings reduces if audit committee comprises of an independent or non-executive directors (Sharma & Kuang, 2014). Equally, Wang, Xie and Zhu (2015) argue that the presence of experienced independent directors in an audit committee restrain earnings management. Conversely, Lin, Hutchinson and Percy (2015) reported a significant positive association between an independent audit committee and earnings management. This suggests that earnings management will increase with an independent audit committee. Similarly, Wan Mohammed *et al*. (2015) established positive association between the two variables.

Furthermore, the effect of foreign ownership on discretionary accruals has been documented in Ali, Salleh and Hassan (2010), which reported that foreign ownership mitigates earnings management in Malaysian companies. However, no study documents the interaction effect of foreign ownership on the association between audit committee independence and discretionary accruals. Since audit committee with majority of members being independent or non-executive directors reduces the possibility of earnings management, the presence of foreign owners in such company is expected to strengthen the committee to restrict managers from managing earnings. This study therefore hypothesizes that:

Hypothesis 10: Foreign ownership (FO) significantly moderates the association between audit committee Independence (ACIND) and Earnings Management (EM) in Nigeria

3.4.11 Moderating Effect of Foreign Ownership on the Association between Audit Committee Expertise and Earnings Management

Mixed results on the association between audit committee expertise and earnings management have been reported. For example, many studies report that audit committee financial expertise reduces earnings management (Badolato *et al*., 2013; Bédard *et al*., 2004; Ioualalen *et al*. 2015; Komal & Bilal, 2016; Wan Mohammed *et al*. 2016; Xie *et al*., 2003). Likewise, Wang *et al*. (2015) emphasized industry expertise in the audit committee. Equally, the Sarbanes-Oxley Act (2002) requested the inclusion of at least one financial expert in the audit committee. On the other hand, other studies document either positive or no association at all between financial expertise in the audit committee and earnings management (Dhaliwal, Naiker & Navissi, 2006; Yang & Krishnan 2005).

In addition, prior studies established an association between foreign ownership and earnings management. For example, Ali *et al*. (2010) established negative association between foreign ownership and earnings management, while Firoozi, Magnan, Fortin and Nicholls (2016) exert that presence of a foreign director in audit committee diminishes the quality of financial reporting in a company. It also reduces the monitoring capacity of audit committee because foreign director is detached from the information networks of the firm. However, no study establishes an association on the interaction of foreign ownership on the association between audit committee financial expertise and earnings management. This study considers foreign ownership as a moderator on the association between audit committee expertise and earnings management. This is because foreign owners are better monitors due to their access to expertise and better talent (Grinblatt, & Keloharju, 2000). Foreign investors transfer their monitoring experience and skills from their "good governance countries" to host countries seen as "poor governance" nations (Kho *et al*., 2009). This indicates that foreign owners ensure that financial experts are included in the audit committee and allowed to work professionally to figure out any sign of earnings management from financial report. In view of the above, this study hypothesis that:

Hypothesis 11: Foreign ownership (FO) significantly moderates the association between audit committee Expertise (ACEXPERT) and Earnings Management (EM) in Nigeria

3.4.12 Moderating Effect of Foreign Ownership on the Association between Female Director in Audit Committee and Earnings Management

There is conflict in the literature on the association between presence of female in audit committee and earnings management. For instance, some studies report negative association suggesting that presence of female in an audit committee curtail earnings managements (Arun *et al*., 2015; Gul, Jaggi & Krishnan., 2007). They postulate that females have unique expertise and better communication skills. Compared to their males' counterpart, they are also more attentive, ethical and thorough. This gives them an edge while engaging external auditors, which could lead to less earnings management. Accordingly, Vermeir and Van Kenhove (2008) are of the view that women have less propensity to commit fraud. Other studies argue that females in audit committee might be effective in mitigating earnings management especially if they are equally members of other board committee (Musa *et al*., 2016).

In contrast, other researchers find either positive or no association between female director in audit committee and earnings management (Carter *et al*., 2003; Erhardt *et al*., 2003; Sun *et al*., 2011). They argue that presence of women in audit committee could increase or add no value to the work of the committee and do not curb earnings management practices. .

Similarly, prior studies established an association between foreign ownership and discretionary accruals. For instance, Ali *et al*. (2010) exert that foreign ownership reduces earnings management considerably. Others such as Firoozi *et al*. (2016) argue that foreign owners do not mitigate earnings management. Their result is consistent with the information asymmetry hypothesis that postulates that distance hinders foreign investors to monitor management effectively, which increase chances of earnings management practices. In spite of the mixed results on the effect of foreign ownership on earnings management, no study establishes the interaction effect of foreign ownership on the association between female director in audit committee and earnings management. This study introduces foreign ownership as a moderating variable, on the association between female director in audit committee and earnings management. In view of the above, this study hypothesizes that:

Hypothesis 12: Foreign ownership (FO) significantly moderates the association between Female Director in audit committee (FEMDIRECT) and Earnings Management (EM) in Nigeria

3.4.13 Moderating Effect of Foreign Ownership on the Association between Audit Committee Meeting and Earnings Management

Prior studies extensively study the association between activism of an audit committee and earnings management. Mixed results were established on whether the activism mitigates earnings management. For instance, negative and significant relationship between frequency of audit committee meeting and discretionary accruals is established in Saleh *et al*. (2007), Stewart and Munro (2007), and Soliman and Ragab (2014). The findings of Ioualalen *et al*. (2015) corroborate the preceding findings revealing a negative association between frequency of audit committee meetings and earnings management. They argued that inactive audit committee hardly reduces earnings management. The number of times the committee meets and engages the external auditors increases the possibility of having an authentic financial report devoid of earnings management. On the other hand, positive association is established between frequency of audit committee meetings and earnings management (Goodwin-Stewait & Kent, 2006). They argue that frequency of audit committee meeting may be a sign of financial difficulty in a firm. Other studies established no association between audit committee frequency of meeting and earnings management (for example, Bédard *et al*., 2004; Jackling & Johl, 2009). Their findings indicate that frequency of audit committee meeting has no impact on earnings management.

In addition, Kho *et al*. (2009) argue that foreign owners are better monitors that can mitigate earnings management. They established a significant association between foreign ownership and earnings management. However, no study establishes the interaction effect of foreign ownership on the association between frequency of the audit committee meeting and earnings management. This study for the first time introduces foreign ownership to moderate the association between audit committee meeting and earnings management. In view of the above, this study hypothesizes that:

Hypothesis 13: Foreign ownership (FO) significantly moderates the association between audit committee meeting (ACMEET) and Earnings Management (EM) in Nigeria

3.4.14 Moderating Effect of Foreign Ownership on the Association between Audit Committee Overlapping and Earnings Management

Researches exploring the effect of audit committee overlapping on earnings management yield contrasting results. Some are of the view that multiple board committee membership including audit committee in the same organization indicates increase expertise. An overlapping exposes the audit committee to diverse policies, which enhances their monitoring capabilities. For example, a study by Habib *et al*. (2015) reveals that discretionary accruals reduce in a firm where at least one member of the audit committee is also a member of the compensation committee especially where managers want to meet or exceed earnings target. Compensation committee in an organization is very important because it is responsible for setting managerial remunerations. The committee equally determines the ceiling of a performance-based incentive rewards for the top management. It benefits the audit committee in understanding how management incentives are set for it to monitor any attempt by the managers to influence their bonus through earnings management.

However, too many membership on other board committees leads to paucity of time, over commit the audit committee members, which result in reducing their monitoring competence (Jiraporn *et al*., 2009). Audit committee being a specialized committee requires availability of time for it to work effectively and to mitigate earnings management. In this vein, some researchers argue that overlapping diminishes the capacity of the audit committee to effectively monitor management or mitigate earnings management especially if it affects the chair or financial expert of that committee (Jaafar, Wan-Hussin & Bamahros, 2016).

Furthermore, extant studies have established an association between foreign ownership and earnings management (Chung *et al*., 2004; Guo *et al*., 2015). They argue that foreign owners especially from strong governance economies are expected to enhance the monitoring capacity of audit committee in host countries due to their experience. Conversely, no study explores the moderating effect of foreign ownership on the association between audit committee overlapping and earnings management. This study explores the moderating effect of foreign ownership on the association between audit committee overlapping and earnings management. In view of the above, this study hypothesizes that:

Hypothesis 14: Foreign ownership (FO) significantly moderates the association between audit committee Overlapping (ACOL) and Earnings Management (EM) in Nigeria

3.4.15 Moderating Effect of Foreign Ownership on the Association between External Auditors' Type and Earnings Management

Studies debated extensively with conflicting results on whether type of external auditors determines the quality of audit and whether that mitigates earnings management. The first argument is that only the Big 4 external auditors provide quality audit as monitoring tool on management. Garven and Taylor (2015) established that the Big 4 auditors restrain managers' ability to manage earnings especially when the aim is to meet the analysts' forecast. Similarly, Huguet and Gandía (2016) established that the Big 4 auditors lessen earnings management more than the smaller audit firms do. Similarly, several other studies find significant negative association between the Big 4 audit and earnings management (for example, Ashtiani, Oskou & Takor, 2016, Asthana, Raman & Xu, 2015; Dimitras, Kyriakou & Iatridis, 2015; Zhu, Lu, Shan & Zhang, 2015). In contrast, several other studies find either positive or no association between the Big 4 auditors and earnings management (for example, Lauwo & Olatunde, 2010; Lopez & Peters, 2012; Khalil & Ozkan, 2016; Piot & Janin, 2005; Siregar & Utama, 2008). They are of the view that Big 4 auditors are busy especially during audit busy season and that could lead to less concentration by the auditors.

In addition, prior studies reveal an association between foreign ownership and discretionary accruals (Guo *et al*., 2015; Kho *et al*., 2009). However, no study examines the interaction effect of foreign ownership on the association between external auditors' type measured by the Big 4 and discretionary accruals. The present study introduces foreign ownership to moderate the association between external auditors' type and discretionary accruals. This study hypothesizes that:

Hypothesis 15: Foreign ownership (FO) significantly moderates the association between External auditors' Type (EAT) and Earnings Management (EM) in Nigeria

3.4.16 Moderating Effect of Foreign Ownership on the Association between External Auditors' Independence and Earnings Management

External auditors' independence has been studied extensively in association with earnings management. The assumption is that auditors need to be independent of the management for it to constrain earning management. It is a requirement of the Sarbanes- Oxley (SOX) that fully independent auditors be in place for proper monitoring of the management. Accordingly, prior studies used different indicator to measure auditors' independence among them is the tenure of the auditors. Some argue that lengthy audit tenure impair auditors' independence and increase the possibility of earnings management (Bowlin, Hobson & Piercey, 2015; Brooks & Guo, 2015; Davis *et al.* , 2002; Garcia-Blandon & Argiles, 2015). They are of the view that auditors are ready to forfeit their independence for longer audit tenure.

Again, prior studies document association between foreign ownership and earnings management. For instance, a negative and significant association between foreign ownership and earnings management is reported (Alzoubi, 2016; Greenaway *et al*., 2014). However, no study document interaction of foreign ownership on the association between external auditors' independence and earnings management. This study introduces foreign ownership as moderator on the association between external auditors' independence and earnings management. In view of this, the present study hypothesizes that:

Hypothesis 16: Foreign ownership (FO) significantly moderates the association between External auditors' Independence (EAIND) and Earnings Management (EM) in Nigeria

3.5 Research Methodology

3.5.1 Research Design

Research design is a “master plan specifying the methods and procedures for collecting and analyzing the needed information” (Zikmund, Babin, Carr, & Griffin, 2012, p.64). It is also been defined as “ a (flexible) set of assumptions and considerations leading to specific contextualized guidelines that connect theoretical notion and elements to dedicated strategy of inquiry supported by methods and techniques for collecting empirical material” (Jonker & Pennink, 2010, p.56).

Accordingly, Sekaran (2003) mentioned three main types of business research. They are exploratory, descriptive and test hypotheses. The knowledge about the research topic determines the kind of the study - whether descriptive, exploratory or hypotheses testing. Explicitly, Zikmund *et al*. (2012) stated that exploratory research is conducted to gather information on a particular problem at hand, and therefore does not provide definite or conclusive results. This type of research is carried out to enable understanding of a new phenomenon, which further studies will be conducted to gain verifiable and conclusive evidence. While descriptive design is carried out where very little is known about the nature of a problem (Sekaran, 2003; Zikmund *et al*., 2012). On the other hand, hypothesis testing is also known as explanatory or causal design. Some associations or variances are explained between or among clusters of variables (Sekaran, 2003).

This study used explanatory research design because it sought to explain the association between the audit committee and external audit characteristics and earnings management. Therefore, hypotheses are developed to explain whether the relationship between the independent variables and dependent variable is significant or not. The study gathers data on audit committee and external audit characteristics, foreign ownership and earnings management from the yearly reports and accounts of companies. Specifically, the source of data is the yearly reports and accounts of non-financial companies quoted on the NSE. The research design concludes by discussing the population and sample of the study, sampling and analysis.

3.5.2 Population of the Study

"Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate" (Sekaran, 2003, p.281). There are 199 listed companies on the NSE as at 31 December 2014. However, the focus of this study is non-financial companies quoted on the NSE as at December 31, 2014. There are total of 143 companies in 10 sub sectors under the non-financial sector, which represent the population for this study. The insurance, banks as well as other financial companies are not included because they are heavily regulated organizations.

The study used two-point filter to arrive at the working population. Firstly, a company must be quoted on or prior to January 1, 2009. Again, it must remain so (not delisted) between January 1, 2009 and December 31, 2014. The purpose of the filtering is to ensure that the firms' publish complete financial reports within the range under consideration of this study. Six years (2009-2014) period are to be covered in this study.

3.5.3 Sample Size

"Sample is a subset of the population. It comprises some members selected from it" (Sekaran, 2003, p.266). Sample is chosen from the entire group of people, events, or things for a research purpose. According to Salkind (2003) to minimize the cost of sampling error, it is important to select an optimal size. An appropriate size is essential in order to avoid inadequate or too huge size. He noted that an inadequate size is not a reasonable representative of the population. Equally, a very huge size is unnecessary as it increases chances of errors, There is a possibility of committing type I error (Alpha error) with too small sample size that is the possibility of rejecting certain finding wrongly when in actual sense ought to be accepted (Sekaran, 2003). In addition, he exerted that too large sample size is not ideal either, due to possibility of committing type II error (Beta error). This means accepting a finding, which ought to be rejected.

This study used panel data. Out of the total population of 143 nonfinancial companies, trading on the NSE on December 31, 2014, the sample of this study is 93 companies whose data on discretionary accrual, foreign ownership, audit committee and external audit characteristics are available from 2009 – 2014.

3.5.4 Unit of Analysis

“Unit of analysis refers to the level of aggregation of data collected during the subsequent analysis stage” (Sekaran, 2003, p.132). Research in social science has either the individual, organization, group or combination of these as a unit of analysis (Creswell, 2012). The unit of analysis for this study is the firm (organization) because the objective of the study is to find out whether audit committee and external audit characteristics instituted by the individual organizations relates to earnings management and moderated by the foreign ownership. The firms through their annual reports provide the data that would help in answering the research questions and testing the research hypothesis.

3.5.5 Sources and Method of Data Collection

This study used secondary source to gather data. The data were sourced from the annual reports and accounts of nonfinancial companies available from the fact book of the NSE. According to Sekaran (2003) secondary data is the one collected by somebody not the person conducting the present research, which can be internal or external. Authors and researchers in the past used secondary data in their researches. For example, COMPUSTAT data base and other secondary sources were used to gather data in US (Deangelo,1986; Dechow *et al*., 1995; Dechow, 1994; Healy, 1985; Jones, 1991; Roychowdhury, 2006).

The data obtained were quantitative on audit committee characteristics (size, independence, expertise, female director, meeting and overlapping) and audit characteristics (external auditors' type and external auditors' independence). Other data obtained from annual reports and accounts of firms were on foreign ownership and the proxies of earnings management. Many previous study on either corporate governance, earnings management or both in developed and developing economies used quantitative data (for example, Abdul Rahman & Ali, 2006; Caliskan, 2010; Carcello *et al*., 2006; García-Meca & Sánchez-Ballesta, 2009; Kwanbo & Abdul-Qadir, 2013; Spohr, 2005; Uddin Bhuiyan *et al*., 2013; Verriest *et al*., 2012; Waweru & Riro, 2013).

3.5.6 Tools of Analysis

This study employed paired- sample t-test to measure the extent of earnings management between 2003 and 2011 revised corporate governance code. The study employed multiple regressions to measure the degree of association between audit committee and external audit characteristics and discretionary accruals among listed companies in Nigeria using modified Jones model (1995).

3.5.7 Model Specification of Earnings Management

This study used modified Jones model introduced by Dechow *et al*. (1995) to measure discretionary accruals. Specifically, the cash flow method is used where accrual is calculated as the variation between earnings and cash flow from operating activities. Discretionary accrual portion from the total accrual is used as proxy for earnings management. Despite the numerous models developed in the literature to measure earnings management, this study choses Dechow *et al*. (1995) model because it improves on the misspecification of prior models such as Jones (1991) model. Similarly, several prior studies have used the model (for example, García-Meca & Sánchez-Ballesta, 2009; Sáenz González & García-Meca, 2014; Uwuigbe *et al.*, 2014).

3.6 Operationalization and Measurement of Variables

This study has three major constructs to be measured namely audit committee characteristics, external audit characteristics and earnings management. This section discusses how this study measures individual variables in each of the construct. According to Creswell (2012) operational definition "is the specification of how you will define and measure the variable in your study" (p.151). These variables may be generic or sometimes unique to one's study. Accordingly, this study used previous empirical studies as a basis for variables adaption or adoption of measurement. Corporate governance mechanisms in Nigeria are based on the corporate governance code (2011). The code did not provide categorical measurement for some of audit committee and external audit variables of this study such as size, independence, female director, overlapping, external auditors' type, external auditors' independence and foreign ownership. That is why most of the measurements used in this study were adopted from previous studies.

3.6.1 Measurement of Earnings Management

Dechow *et al*. (1995) model known as modified Jones model is used to measure earnings management, which is the dependent variable in this study. The model considers receivable accounts, which Jones (1991) model failed to consider. The modified Jones model has better estimating power of discretionary accruals (Dechow *et al.,* 1995). Although, this model also decomposes total accruals into discretionary and non-discretionary accruals like the Jones (1991), its specification power is better. The model tests the capacity of the Jones model by inducing artificial earnings management. Jones (1991) model failed to detect the earnings management by more than 70% of the cases when the managed earnings are only 5% of the total assets (Dechow *et al.,* 1995). Juhmani (2017) asserts that modified Jones model is the most famous and most frequently used model in the detection of earnings management. Accordingly, the model has been used in many recent studies (Ioualalen *et al*., 2015; Juhmani, 2017; Sáenz González & García-Meca, 2014; Uwuigbe *et al*., 2014).

Therefore, to enable the study determines nondiscretionary accruals, this study employs pool OLS regressions (with STATA statistical software) to calculate the coefficients for every industry and for each year, using the model below:

$TAC/A_{it}\text{-}1 = \alpha 1\ (1/A_{it}\text{-}1) + \alpha 2\ (\Delta REV_{it}/A_{it}\text{-}1) + \alpha 3\ (PPE_{it}/\ A_{it}\text{-}1) + \mu_{it}\text{-}1.$

Discretionary accruals (DAC) in the event period are:

$DAC_{it}= TAC/A_{it}\text{-}1 - [\alpha 1\ (1/A_{it}\text{-}1) + \alpha 2\ (\Delta REV_{it}/A_{it}\text{-}1 - \Delta RECit/A_{it}\text{-}1) + \alpha 3\ (PPE_{it}/\ A_{it}\text{-}1)].$

Where TAC_{it}= total accruals for firm i in year t calculated as PBT-CFO

PBT = Profit before tax

CFO = cash flow from operating activities

A_{it}-1 = total assets for firm i in the previous year.

$\Delta REV_{it}/A_{it}$-1 = stand for variation in revenues from i in year t.

ΔREC= is a variation in accruals receivables for firm i in period t.

$PPE_{it}/\ A_{it}$-1 = gross property and equipment for firm i in year t.

μ_{it}-1 = error term for firm i year t.

α1, α2 and α3 stands for coefficients determined based on each industry-and year-specific as used by Sáenz González & García-Meca, 2014. The residuals represent absolute discretionary accruals, which is a proxy for earnings management.

3.6.2 Measurement of Audit Committee Characteristics

Audit committee is an independent variable in this study. It is a specialized and statutory committee saddled by the board to monitor management on behalf of shareholders. The committee acts as an interface between external auditors and management to ensure scrutiny of financial reports to avoid managerial opportunism. The committee minimizes information asymmetry and boosts the confidence of the outsiders (shareholders) to ensure that their interest is protected. Audit committee has numerous characteristics. This study specifically focuses on audit committee size, audit committee independence, audit committee financial expertise, female director in audit committee, audit committee meeting and audit committee overlapping. The measurement for each of these variables is as follows:

3.6.2.1 Audit Committee Size

Audit committee size is used to determine the effectiveness of the audit committee. There is no consensus among researchers on the ideal size. Some advocate for large size (for example, Singh & Harianto, 1989), others such as Jensen (1993) and Abdul Rahman and Ali (2006) advocate for small size audit committee. The corporate governance code (2011) does not mention the minimum or maximum number of audit committee size. The number depends on the complexity of the company's operations. Consistent with previous studies, this study measures audit committee size by the total number of directors in the audit committee (Abbott *et al*., 2005; Crişan & Fülöp, 2014). Table 3.2 summarizes the measurement.

Table 3.2
Measurement of Audit Committee Size

Variables	**Definition**	**Measurement**	**Adopted from**	**Predicted Sign**
ACSIZE	Audit committee size	Total number of members in the audit committee	Abbott *et al*. (2005)	Non-directional

3.6.2.2 Audit Committee Independence

Audit committee independence is used to assess the extent of the committee's independence from managerial influence (Hillman et al., 2000; Jensen, 1993). An independent audit committee is the one that can effectively monitor the management. The corporate governance code (2011) does not mention the measurement of audit committee independence. However, consistent with past studies, this study measures audit committee independence by the proportion of nonexecutive directors (NEDs) to the total number of audit committee members (Abdul Rahman & Ali, 2006; Akileng, 2014). The assumption is that the higher the proportion of NEDs in the audit committee, the more the independence of the committee. An independent audit committee mitigates earnings management. NEDs is used instead of independent director because data on independent directors are not available in the financial reports of public firms in Nigeria. Similar measurement was used in previous Nigerian studies (Miko, 2016; Odewale, 2016). Table 3.3 summarizes the measurement.

Table 3.3
Measurement of Audit Committee Independence

Variables	Definition	Measurement	Adopted from	Predicted Sign
ACIND	A proxy for audit committee independence	Percentage of NED in AC	Abdul Rahman & Ali (2006)	Negative (-)

3.6.2.3 Audit Committee Financial Expertise

Audit committee expertise assess if the committee has a director with finance background or any form of financial literacy since the primary assignment of the committee is to do with financial reporting process. The financial literate person can help other members to understand and interpret financial statements and engage the external auditors accordingly. The code of corporate governance (2011) recommends that directors in the audit committee should possess basic financial literacy and should be able to read financial statements. At least a member should have knowledge of accounting or financial management. Consistent with past studies, this study measures audit committee financial expertise through a dummy variable that considers the value of "1" if at least one audit committee member is financially literate, "0" otherwise (Abbott, Parke, & Peters, 2004; Mishra & Malhotra, 2004; Xie *et al*., 2003). Table 34 summarizes the measurement.

Table 3.4
Measurement of Audit Committee Financial Expertise

Variables	**Definition**	**Measurement**	**Adopted from**	**Predicted Sign**
ACEXPERT	Audit committee financial expertise	a dummy variable that considers the value of “1” if at least one audit committee member is financially literate “0” otherwise	Xie *et al*. (2003) Abbott *et al*. (2004) Mishra & Malhotra (2016)	Negative (-)

3.6.2.4 Female Director in Audit Committee

Gender diversity is to do with whether board or audit committee consists of both male and female. Although there is no consensus on the impact of gender diversity on earnings management, past studies established that presence of female on boards or audit committees enhances monitoring (Adams & Ferreira, 2009; Gul *et al*., 2011). The corporate governance code (2011) does not mention female director in audit committee. However, consistent with past studies, this study measures female director in audit committee as the proportion of female members in audit committee (Campbell & Mínguez-Vera, 2008; Thiruvadi & Huang, 2011). Table 3.5 summarizes the measurement.

Table 3.5
Measurement of Female Director in Audit Committee

Variables	**Definition**	**Measurement**	**Adopted from**	**Predicted Sign**
FEMDIRECT	Female director on Audit Committee	Percentage of female in AC	Thiruvadi and Huang (2011)	Non-directional

3.6.2.5 Audit Committee Meeting

Audit committee measures audit committee level of activity. Prior studies debated on the impact of frequency of audit committee meeting on earnings management. The code of corporate governance (2011) does not state minimum or maximum number of audit meeting but it provides disclosure on the number of meetings held during a financial year and the attendance of each director. Consistent with previous studies, this study measures audit committee meeting as the annual number of meetings held by the audit committee (Soliman & Ragab, 2014; Xie *et al*., 2003). Table 3.6 summarizes the measurement.

Table 3.6
Measurement of Audit Committee Meeting

Variables	Definition	Measurement	Adopted from	Predicted Sign
ACMEET	Audit committee meeting	number of meetings held by the audit committee	Xie *et al*. (2003)	Non-directional

3.6.2.6 Audit Committee Overlapping

Audit committee overlapping is a multiple membership of board committee by the audit committee member. Previous studies debated on the impact of audit committee overlapping on earnings management. The code of corporate governance (2011) does not disallow overlapping, but it warns against excessive board committee membership. Consistent with previous study, this study measures audit committee overlapping as the proportion of audit committee members who are members of other subcommittee (Ferris *et al*., 2003). Table 3.7 summarizes the measurement.

Table 3.7
Measurement of Audit Committee Overlapping

Variables	Definition	Measurement	Adopted from	Predicted Sign
ACOL	Audit committee overlapping	proportion of audit committee members who are members of at least one other sub committee	Ferris *et al*. (2003)	Non-directional

3.7 External Audit Characteristics

The second construct of this study is the external audit characteristics namely external auditors' type and external auditors' independence.

3.7.1 External Auditors' Type

External auditors' type is a measure for audit quality. Agency theory supports that quality audit lessens agency cost. Big 4 audit firms have been used by previous studies as proxy for audit quality. However, there is no consensus on the findings. The Big 4 audit firms are Deloitte, PricewaterhouseCoopers (PwC), Ernst & Young (E & Y) and Klynveld Peat Marwick Goerdeler (KPMG). The code of corporate governance (2011) does not recommend a specific category of external auditor. Consistent with previous studies, this study measures external auditors' type through a dummy variable that considers the value of "1" if the firm is been audited by Big 4 audit firm and, "0" otherwise (Becker *et al*., 1998; Piot & Janin, 2005). Table 3.8 summarizes the measurement:

Table 3.8
Measurement of External Auditors' Type

Variables	Definition	Measurement	Adopted from	Predicted Sign
EAT	External auditors' type	a dummy variable that considers the value of "1" if the external auditors is Big 4," 0" otherwise.	Piot and Janin, (2005) and Becker *et al*. (1998)	Non-directional

3.7.2 External Auditors' Independence

External auditors' independence is required to ensure that financial reporting numbers prepared and submitted by the auditors is reliable. Audit tenure is one of the proxies of external auditors' independence. The assumption is that auditor loses independence with a longer audit period. The code of corporate governance (2011) recommends rotation of external auditor after every 10 years of continuous service to avoid managerial influence on the auditor. The auditor could be re-engaged after 7 years of disengagement. Consistent with a previous study, this study measures external auditors' independence through a dummy variable that considers the value of "1" if the external auditor is above three years with a client and, "0" otherwise (Geiger & Raghunandan, 2002). This study used three years cut-off because its coverage is below ten years. Table 3.9 summarizes the measurement.

Table 3.9
Measurement of External Auditors' independence

Variables	**Definition**	**Measurement**	**Adopted from**	**Predicted Sign**
EAIND	External auditors' independence	a dummy variable that considers the value of "1" if the external auditors is above 3 years with the client "0" otherwise.	Geiger & Raghunandan (2002)	Positive (+)

3.7.3 Measurement of Moderating Variable

The moderating variable in this study is foreign ownership (FO). Previous studies ignore intervening variable and discussed direct relationship between foreign ownership and earnings management (Chung et al., 2004; Desender et al., 2014; Guo et al., 2015). This study introduced moderating variable to moderate the inconsistent relationship between audit committee and external audit characteristics and earnings management. The corporate governance code (2011) does not mention foreign ownership. Consistent with prior study, this study measured foreign ownership as a percentage of shares held by foreign investors (Guo *et al*., 2015). (1986). Table 3.10 summarizes the measurement.

Table 3.10
Measurement of Moderating Variable

Variables	Definition	Measurement	Adopted from	Predicted Sign
FO	Foreign Ownership	Percentage of shares held by foreign investors adopted from Guo *et al*., (2015)	Guo *et al*., (2015)	Negative (-)

3.8 Control Variables

The introduction of control variables is to measure the effect of other external factors that cause disparity in the association between the subject matter. It also control the effect of other variables identified in previous studies that are associated with earnings management. This study includes firm size, profitability, leverage and firm growth as control variables. These variables though not exhaustive were used in earlier studies, and prove to be associated with earnings management (for example, Sáenz González, 2014; Uwuigbe *et al*., 2014).

3.8.1 Firm Size

"Firm size is measured by the natural logarithm of total assets at the end of the year" (Sáenz González & García-Meca, 2014; Habbash *et al*., 2014; Siregar & Utama, 2008; Uwuigbe *et al*., 2014). Larger firms usually have tighter control systems coupled with highly skilled work force with more negotiating power with the external auditors. Equally, investors, market analysts, tax authorities etc. monitor large firms' more than smaller ones. These external monitoring reduced the ability of the managers to manage earnings (Goodwin-Stewait & Kent, 2006; Prior, Surroca, & Tribó, 2008). On the other hand, under the political cost hypothesis proposed by Watts and Zimmerman (1990) opined that larger firms are likely to reduce reported earnings in order to reduce political risk. Habbash *et al*. (2014) found a positive and significant relationship between firm size and earnings management in China. Accordingly, this study predicts a significant relationship between firm size and earnings management.

3.8.2 Leverage

Leverage is measured as proportion of total liabilities to total assets (Habbash *et al*., 2014; Jouber & Fakhfakh, 2012; Saleh *et al*., 2005). However, this study measures leverage as proportion of interest-bearing debt to equity and predict a significant relationship with earnings management. Press and Weintrop (1990) linked high debt with the risk of high level of leverage. Debt covenants hypothesis under the positive accounting theory of Watts and Zimmerman (1978) exert that to avoid technical default in debt covenant highly leveraged firms are inclined to manage earnings upward.

3.8.3 Profitability

Profitability is measured with either return on asset ratio (ROA) or return on equity ratio (ROE). ROA is calculated as net income in year t_{-1} scaled by total assets at year t_{-1}. ROE is net income in year t_{-1} scaled by equity at year t_{-1}. This study uses ROA as a measure of profitability due to the limitation of ROE identified by Lesáková (2007). She identified problem of timing, risk and value problem associated with ROE. Usually ROE tend to be low not because of poor performance especially when a company introduces new product that involve high start-up costs. That means sacrifice of present earnings in anticipation of the future earnings. The risk problem of ROE is that it focuses on return only and disregards the associated risk. The value risk means that a higher ROE is not equal to high return on investment because it measures return on shareholder's investment based on book value not market value. This study also predicts significant relationship between ROA and earnings management.

3.8.4 Firm Growth

Firm growth is measured as the variance in sales and the sales of preceding period. Mcnichols (2000) argue that company with greater projected earnings growth has high possibility of managing earnings through accruals, than companies with lower projected earnings growth. Consistent with Francis and Wang (2004), this study measures growth as the variance in sales and the sales of preceding period.

Table 3.11 summarizes the measurements of the control variables:

Table 3.11
Measurement of Control Variables

Variables	Definition	Measurement	Adopted from	Predicted Sign
FSIZE	Firm Size	natural logarithm of total assets at the end of the year	Sáenz González & García-Meca, 2014	+/-
LEV	Leverage	proportion of interest bearing debt to equity		+/-
PROF	Return on Assets	Net income in year t-1 scaled by total assets at year t-1	Machuga & Teite (2009)	+/-
FGROW	Firm Growth	variance in current sales and sales of the preceding period for firm i in year t,	Francis and Wang (2004)	+/-

3.9 Model of the study

The study examines whether foreign ownership significantly moderates the relationship between audit committee and external audit characteristics and earnings management. A regression is used to find out the magnitude of the impact of each explanatory and control variable on discretionary accruals. The study used the following models to determine the absolute value of discretionary accruals [Abs $(DCA)_{it}$] on the variables of audit committee characteristics, external auditors' characteristics and foreign ownership as moderating variable. The absolute value of discretionary accruals is a good proxy for the combined effect of both income-decreasing and income-decreasing earnings management (Abdul Rahman & Ali, 2006; Bedard & Johnstone, 2004; Klein, 2002). Controlling variables are firm size, leverage, profitability and firm growth according to the following model:

Model 1:

$DAC_{it} = \beta_o + \beta_1 (ACSIZE)_{it} + \beta_2 (ACIND)_{it} + \beta_3 (ACEXPERT)_{it} + \beta_4 (FEMDIRECT)_{it} + \beta_5 (ACMEET)_{it} + \beta_6 (ACOL)_{it} + \beta_7 (EAT)_{it} + \beta_8 (EAIND)_{it} + \beta_9 (Control)_{it} + e_{it}$

Where:

DAC_{it} = Discretionary Accruals ($TAC/A_{it}-1 - [\alpha 1 (1/A_{it}-1) + \alpha 2 (\Delta REV_{it}/A_{it}-1 - \Delta RECit/A_{it}-1) + \alpha 3 (PPE_{it}/ A_{it}-1)]$) for firm i in period t

$ACSIZE_{it}$ = Audit Committee Size (total number of members in the AC) for firm i in period t

$ACIND_{it}$ = Audit Committee Independence (% of NED in the AC) for firm i in period t

$ACEXPERT_{it}$ = Audit Committee Expertise (dummy variable that considers the value of "1" if at least one AC member is financially literate "0" otherwise) for firm i in period t

$FMDIRECT_{it}$ = Female Director in Audit Committee (% of female in AC) for firm i in period t

$ACMEET_{it}$ = Audit Committee Meeting (number of meetings held by the AC) for firm i in period t

$ACOL_{it}$ = Audit Committee overlapping (% of AC members who are members of at least one other subcommittee) for firm i in period t

EAT_{it} = External Auditors' Type (dummy variable that considers the value of "1" if the external auditors is Big 4, "0" otherwise) for firm i in period t

$EAIND_{it}$ = External Auditors' Independence (dummy variable that considers the value of "1" if the external auditors is above 3 years with the client "0" otherwise) for firm i in period t

$Control_{it}$ = Control Variables for firm i in period t

e_{it} = Error Tem for firm $_i$ in period t

To examine the moderating effect of foreign ownership on the association between audit committee and external audit characteristics and earnings management, this study introduces the second model thus:

Model 2:

DAC_{it} = β_o + β_1 *ACSIZE*$)_{it}$ + β_2 (*ACIND*$)_{it}$ + β_3 (AC EXPERT$)_{it}$ + β_4 (FEMDIRECT$)_{it}$ + β_5 (*ACMEET*$)_{it}$ + β_6 (*ACOL*$)_{it}$ + β_7 (EAT$)_{it}$ + β_8 (EAID$)_{it}$ + β_9 (*ACSIZE*$)_{it}$ x FO + β_{10} (*ACIND*$)_{it}$ x FO+ β_{11} (ACEXPERT$)_{it}$ x FO + β_{12} (FEMDIRECT$)_{it}$ x FO + β_{13} (*ACMEET*$)_{it}$ x FO + β_{14} (*ACOL*$)_{it}$ x FO + β_{15} (EAT$)_{it}$ x FO + β_{16} (EAIND$)_{it}$ + β_{17} (Control$)_{it}$ + e_{it}

Where:

DAC_{it} = Discretionary Accruals (TAC/A_{it}-1 - [α1 (1/A_{it}-1) + α2 (ΔREV_{it}/A_{it}-1 - ΔRECit/A_{it}-1) + α3 (PPE_{it}/ A_{it}-1)]) for firm $_i$ in period t

$ACIND_{it}$ = Audit Committee Independence (% of NED in the AC) for firm $_i$ in period t

$ACEXPERT_{it}$ = Audit Committee Expertise (dummy variable that considers the value of "1" if at least one AC member is financially literate "0" otherwise) for firm $_i$ in period t

$FMDIRECT_{it}$ = Female Director in Audit Committee (% of female in AC) for firm $_i$ in period t

$ACMEET_{it}$ = Audit Committee Meeting (number of meetings held by the AC) for firm $_i$ in period t

$ACOL_{it}$ = Audit Committee overlapping (% of AC members who are members of at least one other subcommittee) for firm i in period t

EAT_{it} = External Auditors' Type (dummy variable that considers the value of "1" if the external auditors is Big 4, "0" otherwise) for firm i in period t

$EAIND_{it}$ = External Auditors' Independence (dummy variable that considers the value of "1" if the external auditors is above 3 years with the client "0" otherwise) for firm i in period t

FO = Foreign Ownership (% of shares held by foreign investors)

$Control_{it}$ = Control Variables for firm i in period t

e_{it} = Error Tem for firm i in period t

3.10 Data Analysis

This study employed combination of descriptive, correlation, multiple regression and t-test to analyze data.

3.10.1 Descriptive Analysis

Descriptive analysis is used to describe phenomena of interest (Sekaran, 2003). In those analyses, descriptive information is analyzed statistically in terms of how frequent certain phenomenon of interest occurs (i.e., frequency), the average score or central tendency (mean) and the extent of variability (standard deviation). This study applied descriptive analyses to describe the explained and explanatory variables.

3.10.2 T- test: Paired t-test

This study applied the paired t- test to find the extent of discretionary accruals before and after the revision of code of corporate governance in 2011. The analysis could allow an assessment of the two periods to know, which of the two periods reveal lower discretionary accruals. The means of the sets of variables in the sample data is compared to determine if the average differs from zero.

3.10.3 Data Cleaning

According to Hair *et al*. (2010) and based on the statistical tradition, Data cleaning is necessary prior to statistical analyses. The data of this study were checked and undergone all the processes before analyses.

3.10.4 Data Accuracy

It is also necessary to ensure the accuracy of the collected data. This study compares the data collected with a similar previous study having the similar variables. Similarly, in the process of extracting the figures from the annual reports of the companies, the data of the preceding year are compared with that of the succeeding year.

3.10.5 Missing Values

Missing values occur when there is non-availability of value for analyses on any variable (Hair *et al.*, 2010). The present study came across some missing values, which it ignores based on the recommendation of Hair *et al*. (2010). They recommend that a researcher could ignore missing values of less than 10%.

3.10.6 Identifying Outliers

Prior to analyses, next step in the management of data is to detect multivariate outlier. Outliers are observations that have dissimilar combination of features from the rest of the observations (Hair *et al*., 2010). Furthermore, Bryne (2010) exerts that outliers are observations that have a distinct numerical values within the dataset. Therefore, without proper check, outliers can distort the statistical outcomes. This study returned the outliers to normal using winsorized variables distribution to make the outlier stable. This study uses one percent minimum at both top and bottom to normalize the extreme values that deviate from the original observations. This is done by winsorizing the variables to maintain the features of the original data.

3.10.7 Normality Test

To generalize with precision the results of a study arrived at from a sample, which represent the population, the test for the quality of data distribution is necessary. Wrong generalization is possible if the data distribution extremely deviate from the normal distribution. Skewness and Kurtosis are used to check the normality of variables. According to Hair *et al*. (2010) the benchmark for skewness is +/- 3, while that of Kurtosis is +/- 10 as recommended by Kline (1998). The skewness and kurtosis are within the accepted range.

3.10.8 Multicollinearity

Multicollinearity test checks how independent variables are interrelated in a given model. Where there is extreme interrelation between two variables, one of such variable has to be dropped to allow the one not dropped to explain the changes in the explained variable. Pallant (2005) exerts that correlation of 0.8 and 0.9 are on the high side. Correlation matrix and variance inflation factor (*VIF*) are used to detect multicollinearity. The rule of thumb for the *VIF* is ≤10 (Hair *et al*., 2010). This study used Spearman correlation technique as depicted in Table 4.10, which indicates absence of severe multicollinearity. Similarly, the result of VIF as depicted in Table 4.11 confirms absence of severe multicollinearity.

3.10.9 Heteroskedasticity Test

To satisfy statistical assumptions, this study conducts heteroskedasticity test, which is uneven degree of dissimilarity all through the range of the explained variable, which can mislead the result of a study (Hair *et al*., 2010). It shows homoskedasticity when the residuals differ at same values of the explanatory variables (Osborne & Waters, 2002; Tabachnick & Fidell, 2007). The result for Breusch-Pagan/ Cook-Weisberg test for this study shows chi^2 of 2.65 and insignificant p-value of 0.1037. The result indicates homoskedastic variance.

3.11 Summary

This chapter has discussed the research methodology for this study. It has drawn the sampling design, which is concerned with methods and approach of data collection and the basis for the research design. Precisely, this chapter has described theoretical framework, conceptual definitions, and hypotheses development, underpinning theories, model of the study, population and sample size of the study, data collection and analysis techniques including the statistical assumptions.

CHAPTER FOUR

DATA ANALYSES AND DISCUSSION

4.1 Introduction

The data analyses and the main discussion of this study are presented in this chapter. The chapter begins with the sample size according to industry, then parametric tests, descriptive analysis, statistical assumptions, correlation matrix, and hypotheses testing through multivariate analyses. Findings and discussions followed by robustness tests and the chapter ends with a summary.

4.2 Sample Composition of the Study

There are 199 listed companies in Nigeria as at December 31, 2014. Among them, 143 (72%) companies are non-financial companies, while 56 (28%) are financial. Those under financial were dropped completely since the focus of this study is on non-financial sector. Equally, the financial companies have different regulations. Additional 50 companies were dropped from the non-financial (population of this study) sector due to missing data. The sample data for this study is therefore 93 companies representing 47% of the total listed companies. The total financial year observation is 558 (93 multiplied by 6 years) balanced panel data as depicted in Table 4.1

Table 4.1
Population and Sample of the Study

Population from 2009- 2014	Units	%
Total listed firms in NSE	199	100
Less:		
Financial Companies	56	28
Total population (Non-financial companies)	143	72
Less:		
Firms with missing data	50	25
Total Sample (Total firm- year observations (558)	93	47

Table 4.2, reveals 93 listed firms from 10 categories of industries. The highest number of firms is under consumer goods with 23 firms representing 24.7 % of the total sample. The next highest category is industrial goods with 14 firms representing 15.05 of the total sample. That category is followed by services with 13 firms representing 14%; health care and oil and gas each with 9 firms representing 9.7% each; construction 8 firms representing 8.6%; conglomerate 6 firms representing 6.4%; agriculture 5 firms representing 5.4 %; ICT 4 firms representing 4.3% and the least is natural resources with only 2 firms representing 2.15% as depicted in Table 4.2.

Table 4.2
Categories of Companies Based on Sectors

Industry Type	Industry Code	Number of Companies	Percentage	Observations
Agriculture	1	5	5.4	30
Conglomerate	2	6	6.4	36
Construction	3	8	8.6	48
Consumer Goods	4	23	24.7	138
Health Care	5	9	9.7	54
ICT	6	4	4.3	24
Industrial Goods	7	14	15.05	84
Natural Resources	8	2	2.15	12
Oil and Gas	9	9	9.7	54
Services	10	13	14	78
Total Sample Size	10	93	100%	558

4.3 Estimation of Discretionary Accruals

Modified Jones model originates from the study by Dechow *et al*. (1995). The model has been used extensively in prior studies (for example, Abdul Rahman & Ali; 2006, Habbash *et al*, 2014; Sáenz González & García-Meca, 2014) to measure discretionary accruals by splitting total accruals into discretionary and non-discretionary accruals. This study equally tested the model by adopting OLS method (pooled cross-sectional) of estimation. Table 4.3 shows the parameters used to estimate DAC according to Dechow *et al*. (1995).

Table 4.3

Descriptive Statistics of Parameters Estimation of DAC

$DAC = TAC/A_{it-1} - [\alpha 1\ (1/A_{i,t-1}) + \alpha 2(\Delta REV_{i,t} - \Delta AR_{i,t}) / A_{i,t}] + \alpha 3\ (PPE_{i,t} / A_{i,t-1})]$

Parameter	Mean	Min	Max	Coefficients	T-statistics
TAC/A_{it-1}	24.06	-283.35	963		
$1/A_{i,t-1}$	0.032	0.006	0.740	-103.741	0.868**
$\Delta REV_{i,t} - \Delta AR/A_{i,t}$	3. 879	-102.4	213.04	3.423	0.000***
$PPE_{i,t} / A_{i,t-1}$	0.052	0.000	1.000	-1268.605	0.885**
Durbin Watson					2.275
R^2					0.622
Adjusted R^2					0.620
F- Statistics					303.90***

***, **, * is significant at 1%, 5% and 10% respectively. TAC/A_{it-1} is the total accruals, $1/A_{i,t-1}$ is 1 divided by lagged total assets, $\Delta REV_{i,t} - \Delta AR/A_{i,t}$ is the changes in revenue less change in account receivables divided by lagged total assets and $PPE_{i,t} / A_{i,t-1}$ is the plant, properties and equipment divided by lagged total assets

This study used cash flow approach to estimate total accruals. Hence, TAC = PBT less CFO, where PBT stands for profit before tax; while CFO stands for cash flow from operating activities (Sáenz González & García-Meca, 2014). The mean of the DAC model for these parameters are: TAC/A_{it-1} 24.06, $1/A_{i,t-1}$ 0.032 and 3.879 for $\Delta REV_{i,t} - \Delta AR/A_{i,t}$ and 0.052 for $PPE_{i,t} / A_{i,t-1}$. The coefficient for $\Delta REV_{i,t} - \Delta AR/A_{i,t}$ is expected to be positive. The negative coefficient for $PPE_{i,t} / A_{i,t-1}$ means a decrease in property, plant and equipment due to depreciation in the period under consideration (Davidson *et al.*, 2005). The model splits total accruals into discretionary and non-discretionary accruals implying that is specified correctly.

The maximum values for the parameters TAC/A_{it-1}, $1/A_{i,t-1}$, $\Delta REV_{i,t} - \Delta AR/A_{i,t}$, $PPE_{i,t} / A_{i,t-1}$ are 963, 0.740, 213.04 and 1.00 respectively. The minimum values for the parameters TAC/A_{it-1}, $1/A_{i,t-1}$, $\Delta REV_{i,t} - \Delta AR/A_{i,t}$, $PPE_{i,t} / A_{i,t-1}$ are -283.35, 0.006, -102.40 and

0.000 respectively. The Durbin Watson test is 2.275, which is within the accepted range of 1.50 – 2.50 indicating absence of autocorrelation (Hair *et al*. 2010). The fitness of the model is R^2 = 62.2% and F- value of 303.90, which is significant at 1% level.

4.4 Descriptive Statistics

4.4.1 Descriptive Statistics of Variables

According to Sekaran and Bougie (2010), mean is the average value for a given set of data, it is the most widely used measure of central tendency. Other descriptive statistics include maximum and minimum. Skewness and kurtosis are also shown. Table 4.4 to Table 4.7 show the descriptive statistics of the continuous, dichotomous and control variables.

Table 4.4
Descriptive Statistics of Continuous Variables

Variable	Mean	SD	Minimum	Maximum	Skewness	Kurtosis
DA*C*	0.14	2.08	6.12	23.60	0.44	0.00
ACSIZE	5.48	0.86	2.00	6.00	0.00	0.00
ACIND	0.53	0.11	0.20	0.80	0.17	0.41
FMDIRECT	0.09	0.13	0.00	0.34	0.00	0.00
ACMEET	3.49	0.80	2.00	7.00	0.00	0.00
ACOL	0.30	0.20	0.00	1.00	0.00	0.62
FO	0.48	0.35	0.00	0.88	0.67	0.00

N = 558 DAC is discretionary accruals, *ACSIZE* is audit committee size, *ACIND* is audit committee independence, *FMDIRECT* is the female director in the audit committee, *ACMEET* is audit committee meeting, *ACOL* is audit committee overlapping, FO is foreign ownership

Table 4.4 above depicts descriptive statistics of the continuous variables. It shows that the mean for the discretionary accruals (absolute value) is 0.14. The value is lower than the average of 0.549 reported by Miko (2016) for the same Nigerian companies. The value is higher than that of Saleh *et al*. (2007) that reported -0.013 in Malaysia, and 0.095 reported by Khalil and Ozkan (2016) for Egyptian firms. The least discretionary accrual is 6.12, which differs from zero. That indicates that the companies under consideration engage in earnings management. The highest value of discretionary accruals is 23.60.

The average number of audit committee members (*ACSIZE*) is five (5) with the lowest of two (2) and highest six (6). The code of corporate governance 2011 does not restrict the number of audit committee members; the code only requests the audit committee size to be based on the nature, uniqueness, size and complexity of the company.

The average percentage of independent audit committee members (*ACIND*) is 53%, the minimum is (20%) and the maximum 80%. Based on the sample of this study, on average, audit committee comprises of 53% NEDs. The corporate governance code 2011 does not mention the proportion of executive directors and NEDs. The 20% minimum indicates that not less than 20% NEDs are in every audit committee. The maximum ratio is 80% indicating high proportion of NEDs in the audit committee. A very high proportion of NEDs signifies higher independence of the audit committee.

Furthermore, the mean of female director in audit committees (FMDIRECT) is 9.4 percent, the minimum is zero and the maximum is 34%. This indicates that only few public companies in Nigeria have women in the composition of their audit committees. The corporate governance code 2011 was silent on the inclusion of women in audit committee. Generally, women are few in board composition in Nigeria.

The audit committee meets on the average three (3) times annually, minimum of two (2) and a maximum of seven (7). The revised code in 2011 did not mention either minimum or maximum number of meetings to be held by the audit committee. However, the code requests the companies to disclose the number of meetings held as well as number of meetings attended by each of the audit committee member.

Furthermore, the audit committee overlapping (*ACOL*) has an average of 30%, minimum of zero (0) and a maximum of 100%. This indicates that some companies have few overlapping audit committee members, while others have many. The corporate governance code 2011 did not disallow overlapping, it only cautioned firms against over-stretching directors with board committee assignment.

Foreign ownership (*FO*) which is the moderating variable in this study has a mean of 48%. This shows that there is substantial foreign ownership in the sample of this study. The minimum is zero (0) and the maximum is 88%. The code of corporate governance 2011 does not mention foreign ownership. However, the Nigerian Law under the NIPC allows foreign investors to own up to 100% shares in Nigeria (excluding oil and gas sector). Table 4.5 shows the descriptive analysis of the dichotomous variables:

Table 4.5
Descriptive Statistics of Dichotomous Variables

Variable	Mean	SD	Minimum	Maximum	Skewness	Kurtosis
ACEXPERT	1. 00	0.00	1. 00	1. 00	0.00	1.64
EAT	0.59	0.49	0.00	1. 00	0.00	0.77
EAIND	0.54	0.22	0.00	1. 00	0.65	0.01

Table 4.5 shows that the audit committee expertise (*ACEXPERT*) is a dichotomous variable that considers the value of "1" if at least one audit committee member is financially literate, "0" otherwise. The average of financial experts in the audit committee is one, the lowest is one person and the highest is one person. This indicates that all the companies have at least one financial literate member in their audit committee, which means full compliance by the companies in the sample data with the corporate governance code (2011). The revised corporate governance code (2011) recommends inclusion of at least one member with accounting or financial management background in the audit committee. This variable will not be included in the regression analyses because of full compliance by the companies in the sample data.

On the external audit characteristics, external auditors' type (EAT) being a dichotomous variable has an average of 59%. It indicates that 329 firm's years in the sample data were audited by the Big 4, as against 229 firms' year by the non-Big 4 auditors. It further shows that many (59%) listed companies in Nigeria have high quality of audit expected to mitigate earnings management. The code of corporate governance 2011 does not recommend category of external auditor.

The second external audit characteristic is the external auditors' independence (*EAIND*), which is also a dichotomous variable. It has an average of 54%, minimum of zero and maximum of one (1). This indicates that most listed companies in Nigeria maintain an external auditor for more than three (3) years consecutively. The code of corporate governance 2011 recommends rotation of external auditor every ten (10) years to ensure the independence of the auditor. However, this study adopts three (3) years consistent with the study by Geiger and Raghunandan (2002). Table 4.6 shows descriptive analysis of the control variables:

Table 4.6
Descriptive Statistics of Control Variables

Variable	Mean	SD	Minimum	Maximum	Skewness	Kurtosis
FSIZE	9.75	0.77	6.52	11.98	0.13	0.11
LEV	0.09	0.06	0.01	0.49	2.46	3.44
PROF	0.26	2.72	-3.73	6.30	0.19	0.01
FGROW	0.11	0.33	0.00	1.70	0.00	0.00

N=558 FSIZE is firm size, LEV is leverage, PROF is profitability, FGROW is firm growth

From Table 4.6 the FSIZE is the natural logarithm of total assets at the end of the year. The mean of 9.75 shows there are substantially big companies in the sample data. LEV is the proportion of interest- bearing debt to equity. The mean of interest-bearing debt to equity is 0.09 (9%). The 1% is the minimum of interest-bearing ratio and the maximum is 49%. PROF is measured using ROA, which is the net income in year t-1 scaled by total assets at year t-1. The mean is 0.26 (26%), minimum -3.73 and a maximum of 6.3. This suggests that some companies are operating at loss while others are extremely profitable. FGROW is the variance in current sales and sales of the preceding period for firm i in year t. The average of mean of 11% shows that only few companies are growing by increasing sales. The average is 0.11 (11%), minimum of zero (0) and maximum of 170%. This shows that some companies are static while others are fast growing.

Furthermore, to check the normality of the data distribution, a normality test was conducted. Skewness and Kurtosis are the basic statistical tools employed to check normality. Hair *et al*. (2006) recommended a higher threshold of ± 3 for skewness. Table

4.4 - Table 4.7 show the skewness and kurtosis for this sample, which ranges from 0.00 to 2.46 for skewness and 0.00 to 3.44 for kurtosis. This indicates that the study presents a moderate skewness, which is normally distributed.

4.4.2 Discretionary Accruals Based on Industry

Descriptive statistics of discretionary accruals are done according to industries based on categorization by SEC in Nigeria. The industries are agriculture, conglomerates, construction and real estate, consumer goods, healthcare, ICT, industrial goods, natural resources, oil and gas and services industry. All these industries are represented in the sample of this study. Table 4.7 shows the details of the industries:

Table 4.7
Descriptive Statistics of Discretionary Accruals According to Industry

Industry	Mean	SD	Min	Max	N
Agriculture	0.523	1.840	0.003	7.455	30
Conglomerate	0.010	0.061	0.002	0.367	36
Construction	0.138	0.999	1.874	2.194	48
Consumer Goods	0.330	0.940	1.973	3.330	138
Health Care	0.407	0.823	1.214	3.199	54
ICT	0.157	0.584	1.025	1.574	24
Industrial Goods	0.357	0.907	1.619	3.882	84
Natural resources	1.127	1.102	0.925	2.627	12
Oil & Gas	0.613	0.865	2.106	2.374	54
Services	0.232	0.718	1.188	2.155	78

N =558

The lowest mean of discretionary accruals are in conglomerate industry (mean 0.01, minimum 0.002 and maximum 0.367). The highest mean of discretionary accruals are in the natural resources (mean 1.127, minimum 0.925 and maximum 2.627). The highest mean of discretionary accruals in the natural resources may be due to the technical nature and the high capital requirement of the industry. Similarly, the sector with the lowest earnings management is conglomerate (0.02) and the highest is agriculture (7.455). Figure 4.1 graphically depicts the mean, minimum and maximum absolute discretionary accruals by industry.

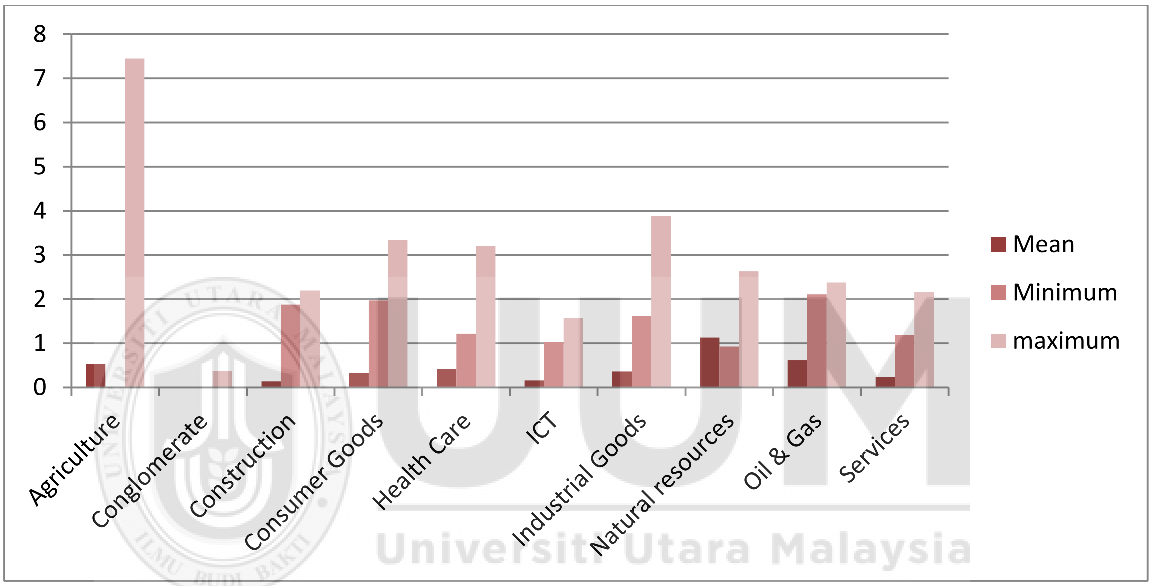

Figure 4.1 DAC by Sector

4.4.3 Comparison between Pre- and Post-Corporate Governance 2011

This study used paired t-test to find out the level of earnings management before and after the introduction of corporate governance code in Nigeria in 2011. It is to assess extent of earnings management between the two periods. A paired sample t-test or dependent t-test is a statistical tool used to analyze data in which a factor is measured prior and after an intervention. The means of the sets of the variables in the sample data is compared to determine if the average differs from zero. This study used three years (2009-2011) as pre-period. The year 2011 being an inception year is included in the pre-period because the revised code became effective on April 1, 2011 and it was difficult for the public companies to comply fully with the provisions of the code until 2012 financial year (Osemeke & Adegbite, 2016). Similarly, a study by Odewale (2016) on executive compensation includes year 2011 in the pre-period. The post-period years are equally three (2012-2014). In each of the period, discretionary accruals for 93 companies were considered. Prior to the paired t-test, the data passed a normality test using Shapiro-Wilk test of normality. The p-value falls below 0.05 indicating that the data is well modeled by a normal distribution. Table 4.8 below depicts the result of the paired-sample t-test:

Table 4.8
Comparison between 2003 and 2011 Corporate Governance Code

Variable	**Obs**	**Means**	**Std.Err**	**Std Dev.**	**95% Conf.**	**Interval**
Post	279	-0.12453	0.06488	1.06015	-0.25227	0.00322
Pre	279	0.15991	0.05516	0.90134	0.05131	0.26852
Diff	279	-0.28444	0.08498	1.38856	-0.4517	-0.11713

Mean (diff) = mean (post - pre)		t = -3.3472
Ho: mean (diff) = 0		degrees of freedom = 278
Ha: mean (diff) < 0	Ha: mean (diff)! = 0	Ha: mean (diff) > 0
Pr (T < t) = 0.0005	Pr(|T| > |t|) = 0.0009	Pr(T > t) = 0.9995

Table 4.8 depicts a mean difference in discretionary accruals between pre and post revised corporate governance of -0.28444 with standard deviation of 1.388856, a standard error of the mean 0.08498, and 95% confidence intervals of -0.4517 to -0.11713. The result also shows t-value of 3.3472, the degree of freedom of 278 and statistical significance (2-tailed p-value) of the paired t-test (Pr **(**|T| **>** |t|**)** under Ha: mean (diff)**! =** 0), which is 0.0009. As

the p-value is less than 0.05 ($p<0.05$), it can be interpreted that there is a statistically significant difference between the two periods. In other words, the difference of discretionary accruals between pre and post period is not equal to zero. It indicates that the level of discretionary accruals before the revision of the code is higher than after the revision.

From the result, it can be interpreted that the revised corporate governance code (2011) has achieved one of its objective by strengthening corporate governance mechanism through reduced level of earnings management. However, from the result it is difficult to conclude whether the reduction in opportunistic earnings management was caused by improvement in audit committee or external audit characteristics. This is evident by the fact that the revised code did not categorically provide measurement for some of the variables covered in this study such as audit committee size, independence, meeting and female director in audit committee. Companies are at liberty to apply the international best practice. Secondly, another reason for this result is connected with foreign investment. The argument put forward by Okike and Adegbite (2011) is that an increase in foreign investment continues to affect the corporate governance practice in Nigeria. As foreign investors strive to protect their investment, adherence to corporate governance best practice improve among public companies. They provide statistics that the total foreign portfolio investment in 2011 increased by 46.9% to NGN 516.47billion (£2.35billion British Pound) from NGN381.34billion (£1.6 billion British Pound) in 2010 through the nation's capital market (Nigerian Stock Exchange). Accordingly, the NSE reported an increase of 59.81% of Foreign Portfolio Investment (FPI) by the mid-year (June 30, 2017) to NGN430.23billion compared to the same period last year (June 30, 2016).

This analysis answered the research question number one on the extent of earnings management in the pre-and post-corporate governance code 2011 periods.

4.5 Statistical Assumptions

Hair *et al*., (2010) suggests that variables should be tested for normality, multicollinearity and linearity prior to regression.

4.5.1 Model Specification Test

One of the important tests is specification test. This is to check whether a model is well-specified with no omitted variables. The result of Ramsey test showed F- statistics of 0.91and insignificant P value statistics of 0.5935. That indicates a well- specified model.

4.5.2 Correlation Matrix of Variables

Correlation quantifies the extent to which two variables are associated (Hair *et al*. (2010). The correlation matrix shows the strength of association between explained and explanatory variables and the association among the explanatory variables. As a prerequisite for running a linear regression, the correlations of the independent variables are checked for multicollinearity. Pearson coefficients and their level of significance at one- tailed are calculated through the correlation as depicted in Table 4.9.

Table 4.9

Correlation matrix of variables

Variables	DAC	*ACSIZE*	*ACIND*	*FMDIRECT*	*ACMEET*	*ACOL*	*EAT*	*EAIND*	*FO*	*FSIZE*	*LEV*	*PROF*	*FGROW*
DAC	1.000												
ACSIZE	0.105**	1.000											
ACIND	-0.095**	-0.181***	1.000										
FMDIRECT	-0.408**	-0.022	-0.084**	1.000									
ACMEET	-0.280***	0.018	0.031	0.079***	1.000								
ACOL	0.279***	-0.018*	-0.121***	-0.402***	-0.082*	1.000							
EAT	-0428***	-0.020	-0.083**	0.198***	0.296***	-0.413***	1.000						
EAIND	0.477***	-0.016	0.003	-0.010	-0.259***	-0.120	-0.001	1.000					
FO	-0.469**	-0.026	-0.003	0.010	-0.262***	-0.122*	0.001	-0.287***	1.000				
FSIZE	-0.086**	-0.044	-0.007	-0.002	0.293***	0.126*	0.002	-0.258***	0.198***	1.000			
LEV	0.005***	-0.028	0.020	0.001	0.043	0.023	0.008	-0.0167***	0..170***	0.182***	1.000		
PROF	0.033**	0.012	-0.005	0.001	0.009	0.033	0.073	0.375***	-0.375***	-0.407	-0.169***	1.000	
FGROW	0.015	-0.062	0.003	-0.007	-0.259***	0.002	-0.017	0.009	-0.001	-0.007	-0.003	-0.001	1.000

***, **, * indicate statistical significance at 1, 5 and 10%, respectively at one tailed. DAC is the absolute discretionary accruals, ACSIZE is audit committee size, *ACIND* is audit committee independence, *FMDIRECT* is the female director in audit committee, *ACMEET* is audit committee meeting, *ACOL* is audit committee overlapping, EAT is external auditors' type, EAIND is external auditors' independence, FO is foreign ownership, FSIZE is firm size, LEV is leverage, PROF is profitability, FGROW is firm growth

The result of the Pearson correlation matrix is shown in Table 4.9. The values of the correlation coefficient range from -1 to 1. The sign (positive or negative) of the correlation coefficient shows the direction of the relationship. Large value of the correlation coefficient shows the strength of the association. The correlation coefficients on the main diagonal are 1.0, because each of the variables has a perfect positive linear association with itself. The results in Table 4.9 indicates that audit committee independence (*ACIND*), female director in audit committee (FMDIRECT), audit committee meeting (ACMEET), external auditors' type (EAT), foreign ownership (FO) and firm size (FSIZE) are negative and significantly associated to discretionary accruals. Therefore, there is possibility for these variables to mitigate earnings management.

On the other hand, audit committee size (ACSISE), audit committee overlapping (*ACOL*), external auditors' independence (*EAIND*), leverage (LEV) and profitability (PROF) are positive and significantly associated to discretionary accruals. This indicates a possibility for these variables to increase earnings management. Firm growth (FGROW), which is a control variable is the only variable with positive but insignificant association with the discretionary accruals.

Furthermore, audit committee independence (ACIND) and audit committee overlapping (ACOL) are negative and significantly associated with (ACSIZE). This indicates that large audit committees are associated with fewer NEDs and fewer overlapping members. Female director in audit committee (FMDIRECT), audit committee overlapping (ACOL) and external auditors' type (EAT) are negative and significantly associated with audit committee independence (ACIND). This indicates that audit committees with high NEDs are associated with fewer female directors and overlapping members and not audited by the Big 4 auditors.

Similarly, foreign ownership (FO) is negative and significantly associated with external auditors' independence (EAIND), audit committee meeting (ACMEET) and audit committee overlapping (ACOL) indicating that companies with high foreign ownership are associated with shorter audit tenure, infrequent audit committee meeting and fewer overlapping members.

According to Hair *et al*. (2010), the correlation benchmark is 0.8. The highest correlation among the variables of this study as shown in Table 4.9 is 0.477 between external auditors' independence (EAIND*)* and DAC indicating that companies with high audit tenure report high discretionary accruals. This is within the accepted range.

4.5.3 Multicollinearity

Colleniarity means strong correlation between two variables. However, when more than two explanatory variables correlate perfectly, multicollinearity has occurred. It is therefore necessary to consider removing one of the highly correlated variables. According to Hair *et al*. (2010) the variables are uncorrelated when the results of the *VIF* in each of the independent variable is equal to 1. However, there is high correlation or multicollineriaty among independent variables when *VIF* is > 10. This study assesses the presence of multicollinerity as shown in Table 4.11. The test results showed a maximum *VIF* of 1.51

under *FSIZE* and the least of 1.02 under *FGROW* as shown in Table 4.10 below. The mean of the *VIF* shows 1.16, which suggests that that the variables are not perfectly correlated.

Table 4.10
VIF

Variables	VIF	1/VIF
SIZE	1.29	0.772506
ACIND	1.15	0.869565
ACEXPERT	1.14	0.879701
FMDIRECT	1.03	0.968721
ACMEET	1.28	0.783752
ACOL	1.10	0.908283
EAT	1.24	0.804162
EAIND	1.03	0.966989
FO	1.21	0.829817
FSIZE	1.51	0.662251
LEV	1.07	0.932649
PROF	1.03	0.966339
FGROW	1.02	0.977809
Mean *VIF* 1.17		

4.5.4 Heteroskedasticity Test

According to Hair *et al*. (2010) homoscedasticity of the variance is when the residuals are steady and are scattered randomly through several estimations in the presence of unequal variance. The benchmark is when H_0 (constant variance) p-value is above 0.05, meaning that the variance is homoscedastic. This study used *STATA* (version 14) to test (Breusch-Pagan/ Cook-Weisberg test) for heteroscedasticity, in order to see how the variance behaves. The result (chi^2 (1) = 2.65, prob > chi^2 = 1037) shows that the data is homoscedastic. The chi^2 is not significant at all levels.

4.5.5 Linearity Test

Linearity test is imperative and is part of the fundamental assumptions of the regression technique that the association between the explanatory and explained variables is linear (Hair *et al.*, 2010). The residuals are plotted in a histogram to check the linear association between the explained and explanatory variables. The curve distribution obtained by this study is a normal one as depicted in figure 4.1

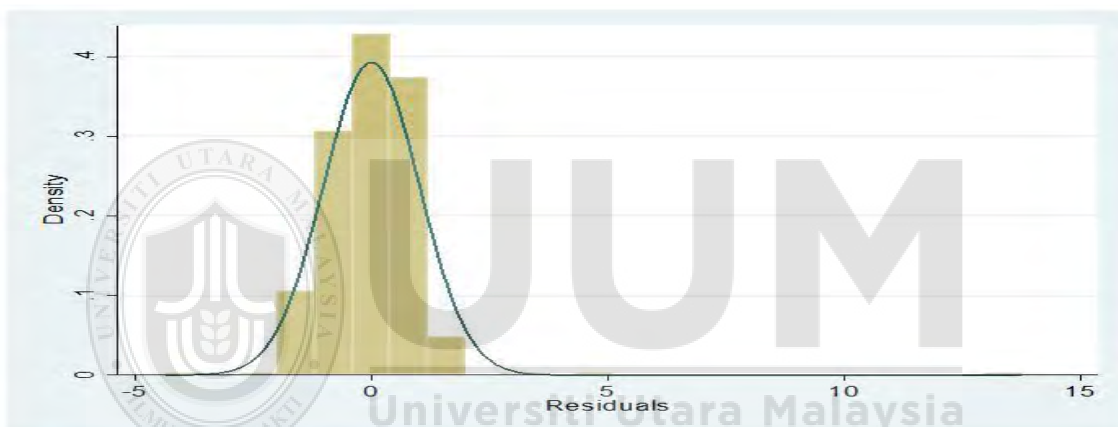

Figure 4.2: Normality Curve of the Residuals

4.6 Panel Data Analysis

"A longitudinal, or panel, data is one that follows a given samples of individuals over time, and thus provides multiple observations on each individual in the sample" (Hsiao, p.9). With panel data, a researcher can control variables that cannot be measured or observe. A researcher can also include variables at different stages or level of an analysis. Analyses with panel data could either be though pooled ordinary least squares (OLS), fixed effect (FE) or random (RE) techniques based on certain assumptions (Torres-Reyna, 2007).

4.6.1 Pooled Ordinary Least Squares Model

According to Hsiao (2003), pooled OLS model used single regression estimates for the sample observations throughout the period of analyses. Batalgi (2008) noted that OLS assumes that the independent variables contains all the features of every unit in the dataset while the entire unobserved effects are dropped employing pooled OLS for the model to fit. It suggests that the slope of the coefficient and intercepts of the variables is constant across time in the sample data.

According to Wooldridge (2003), Guss-marker theorem OLS method is the ideal technique used in estimation if error terms are identically distributed and the same time independent. Similarly, panel data assumes that individual units (countries, firms or individuals) are dissimilar (heterogeneous) from each other. The explained and explanatory variables among the units might differ over time (Hsiao, 2003).

4.6.2 Fixed Effects Model (FE)

FE explores the association between dependent and independent variables within a particular entity (Torre-Reyna, 2007). Each of these entities has their distinct features that are likely or unlikely affect the independent variables. This model takes care of precise effect in a panel data and analyzes the outcome of those variables that vary over time (Frees, 2004).

Torre-Reyna (2007) further argue that in applying FE, the assumption is that some features of the individual entity may influence or bias the independent variables , which necessitates need for control. That is the reason why the error term and the constant are ideally not supposed to correlate. In a situation where the constant and the error term correlates, FE is not suitable because it may lead to unreliable results. FE is suitable when the interest of a study is to analyze the effect of variables that changes over time.

4.6.3 Random Effect Model (RE)

The reason for using RE model is the assumption that the difference across units is random and entirely not related with the explanatory variables in the model (Torre-Reyna, 2007). He further asserts, "If you have reason to believe that differences across entities have some influence on your dependent variable then you should use random effects" (p.25). He pointed that given the high possibility that the variation across entities have some impact over the independent variables in the panel dataset, the use of RE model is more suitable. He argue that the intercept in the RE model shift near the common intercept.

4.7 Criteria for Model Selection

Batalgi (2008) pointed that the first test to be carried-out in panel data analysis is to find out the suitable model to be used between pooled OLS and random effect and generalized least squares (RE-GLS). This is to determine whether the sample data is heterogeneous or not by applying the Breusch-Pagan/ Cook-Weisberg test. The test indicates whether the sample data is heterogeneous or otherwise. The result for Breusch-Pagan/ Cook-Weisberg test for this study shows an insignificant p-value of 1037. This indicates that pooled OLS model is the most suitable for this study (Gelman & Hill, 2007).

Additionally, Hausman test could be carried-out in order to select most appropriate model between FE regression model and RE model if the result of the Breusch-Pagan/ Cook-Weisberg test is significant. The two models are run separately and compare the results using the Hausman (Greene, 2008; Torres- Reyna, 2007). This test is not necessary in this study having satisfied the assumptions for pooled OLS method of estimation.

This study satisfied all the OLS assumptions based on the result of the model specification (sub-section 4.5.1), correlation (sub-section 4.5.2), multicollinearity and VIF (sub-section 4.5.3), heteroskedasticity (sub- section 4.5.4) and linearity (sub-section 4.5.5)

Accordingly, this study applied pooled OLS cross sectional data analyses to test the association between audit committee and external audit characteristics and discretionary accruals. Table 4.11 depicts an insignificant Breusch-Pagan/cook-Weisberg test (chi^2 (1) = 2.65, prob > chi^2 = 0.1037).

Table 4.11
Breusch-Pagan/Cook-Weisberg Test

HO: constant Variance	
Variables: fitted values of DAC	
Chi(1) =	2.65
Prob > chi^2 =	0.1037

4.8 Multivariate Analyses for Determinants of Discretionary Accruals

Multivariate analysis is a tool for statistical analysis, which contains data with numerous variables with the aim of finding dependence structure or associations between those variables (Chen, 2005). This study aims to find an association between audit committee and external audit characteristics and moderating role of foreign ownership on discretionary accruals in Nigeria. This study used multivariate analysis. The results as presented in Table 4.12.

4.8.1 Results and Discussion of Models

The results, findings and discussion of the present study are presented in this section. Further analyses to back the findings of this study are conducted.

4.8.1.1 Determinants of Discretionary Accruals

Multiple regressions are conducted to measure the behavior of the relationship between the DV, the IVs, and the control variables (Sekaran & Bougie, 2012). The coefficient of determination (r^2) measures the quantity of change in the dependent variable due to change in any of the independent variable (Zikmund *et al*., 2012). It depicts the strength of the whole relationship called goodness of fit.

Table 4.12 presents the result of the regression analysis of this study based on two models. Model one shows the result of the direct relationship between independent variables and the dependent variable. Model two includes interaction effect (moderating) between foreign ownership and the independent variables. The result of model one shows R^2 of 63.6%, F- statistics of 73.26 at 1% level of significance. That means 63.6% of the explanatory variables explained the model. The R^2 (model one) of this study is lower compared to the study by Amar (2014) of 68%, using modified Jones model (1995) for French companies on the effect of independent audit committee on earnings management. However, it is higher than 25% reported by Abbott *et al*. (2004) in the US. The model shows that ACSIZE, ACIND and EAT are negative and significantly related to discretionary accruals and may reduce earnings management. On the other hand, FMDIRECT, ACOL and EAIND are positive and significantly related with discretionary accruals and may increase earnings management.

The result of model two shows R^2 of 69.7%, F- statistics of 68.49 at 1% level of significance. That means 69.7% of the explanatory variables explained the model. The model shows that ACSIZE, ACIND, ACMEET and EAT are negative and significantly related to discretionary accruals and may reduce earnings management. On the other hand, ACOL is negative and significantly related to earnings management and may increase earnings management.

Table 4.12
Models for Determining Discretionary Accruals

		Model One			Model Two		
Variables	sign	Coeff.	t-statistics	p-value	Coeff.	t-statistics	p-value
ACSIZE	±	-0.102	-1.65	0.09*	0.029	0.51	0.613
ACIND	–	-0.048	-1.51	0.068*	0.151	0.58	0.561
FMDIRECT	±	0.051	1.83	0.042**	-0.062	-0.19	0.849
ACMEET	±	0.027	9.68	0.599	0.164	1.2	0.36
ACOL	±	0.002	1.39	0.082*	0.029	2.3	0.022**
EAT	±	-0.027	-13.6	0.050**	-0.064	-0.98	0.326
EAIND	+	0.073	2.38	0.07*	0.434	1.89	0.059*
FSIZE	±	0.203	2.77	0.00***	0.195	2.69	0.007*
LEV	±	0.302	0.61	0.010*	-0.002	-0.63	0.53
PROF	±	0.148	2.5	0.013*	0.351	1.75	0.081*
FGROW	±	0.25	0.85	0.394	1.35	1.01	0.311
FO	±	-0.27	-3.54	0.00***	-0.051	-0.13	0.095*
*FO*ACSIZE*	±				-0.176	-1.54	0.04**
*FO*ACIND*	–				-0.052	-183	0.022**
*FO*FMDIRECT*	±				0.061	0.56	0.577
*FO*ACMEET*	±				-0.049	-0.75	0.090*
*FO*ACOL*	±				0.012	0.13	0.003*
*FO*EAT*	±				-0.048	-0.76	0.000***
*FO*EAIND*	+				-0.042	-1.4	0.83
Constant	±	-2.2	-3.36	0.000***	-2.007	-3.05	0.000***
R- Squared			0.636			0.697	
Adj R²			0.627			0.705	
F-statistics			73.26			68.49	
P-value			0.000***			0.000***	

N = 558. ***, **, * is significant at 1%, 5% and 10%, respectively at two tailed. Model 1 represents regression model of this study before moderation while the model 2 represents the regression model with moderation impact of foreign ownership in the firm. Note: absolute discretionary accruals is the dependent variable, ACSIZE is audit committee size, ACIND is audit committee independence, FMDIRECT is female director in audit committee, ACMEET is audit committee meeting, ACOL is audit committee overlapping, EAT is external auditors' type, EAIND is external auditors' independence, FO is foreign ownership, FSIZE is firm size, LEV is leverage, PROF is profitability, FGROW is firm growth, FO*ACSIZE is the interaction effect of foreign ownership in audit committee size, FO*ACIND is the interaction effect of foreign ownership in audit committee independence, FO*FMDIRECT is the interaction effect of foreign ownership in female director in audit committee, FO*ACMEET is the interaction effect of foreign ownership in audit committee meeting, FO*ACOL is the interaction effect of foreign ownership in audit committee overlapping, FO*EAT is the interaction effect of foreign ownership in external auditors' type, FO*EAINDT is the interaction effect of foreign ownership in external auditors' independence

4.8.1.1.1 Audit Committee Size and Earnings Management

The result in Table 4.12 shows how the individual independent variables relate to the dependent variable (DV). This study anticipates a significant relationship between audit committee size and discretionary accruals without predicting a direction. Model 1 shows a negative and significant relationship between audit committee size and discretionary accruals (DAC). It reveals that for every unit increase in *ACSIZE*, DAC decreases with 0.102, t – statistics is -1.65, which is significant at 10%. The result supports both RDT and agency theory. The more external resources are appointed as directors, the bigger the size of the board. A large size board or audit committee can bring in more resources to the company such as experience and expertise (Al-Rassas & Kamardin, 2015; Pfeffer, 1972, 1973; Singh & Harianto, 1989). These external resources can enhance the audit committees' effectiveness in monitoring management, which can lead to lower earnings management. Effective monitoring of the management is the focus of the agency theory. Prior studies established similar result (García-Meca & Sánchez-Ballesta, 2009; Juhmani, 2017; Saleh *et al*., 2005; Zahra & Pearce, 1992). Therefore, the non-directional hypothesis 1 is supported.

The corporate governance code 2011 is not specific on either minimum or maximum number of directors in the audit committee. It only provides that the size of the committee should depend on the nature of the company, its size and uniqueness of activities. In the sample data of this study, directors in the audit committee range from two to six, which means that audit committee size of the companies depends on their nature and complexities.

Model 2 (prior to moderation of foreign ownership) reveals insignificant association between audit committee size and discretionary accruals. That means audit committee size does not influence earnings management. This result is consistent with previous studies (Abbott *et al*., 2004; Davidson *et al*., 2005; Soliman & Ragab, 2014).

4.8.1.1.2 Audit Committee Independence and Earnings Management

This study expects and predicts a negative and significant relationship between audit committee independence and discretionary accruals. The regression result in model 1 shows that for every one unit increase in the audit committee independence (*ACIND*), discretionary accruals decreases by 0.048, which is significant at 10%. The result is consistent with the expectation of this study. It also supported the agency theory that an independent audit committee is an effective monitoring tool that can lessen earnings management. Previous studies reported similar results (for example, Al-Rassas & Kamardin, 2016; Amar, 2014; Crişan & Fülöp, 2014; Dechow *et al*., 1996; García-Meca & Sánchez-Ballesta, 2009; Pathak *et al*., 2014; Saleh *et al*., 2007; Soliman & Ragab, 2014; Xie *et al*., 2003). The result supports hypothesis 2.

The code of corporate governance (2011) in Nigeria has not provided specific measurement for audit committee independence. However, this study used the proportion of non-executive directors in the audit committee to measure audit committee independence.

Model 2 (prior to moderation effect of foreign ownership) reveals an insignificant relationship between audit committee independence and discretionary accruals. The results is in line with previous findings (for example, Abdul Rahman & Ali, 2006; Kusnadi *et al*., 2016; Okougbo & Okike, 2011; Yatim, Iskandar & Nga, 2016).

4.8.1.1.3 Female Director in Audit Committee and Earnings Management

This study expects a significant relationship between female director in audit committee and earnings management. The result of model 1 as depicted in Table 4.12 has a coefficient value 0.051, t- statistics 1.83 and p- value 0.042. The results indicate that female director in the audit committee (*FMDIRECT*) is positive and significantly related to discretionary accruals at 5% level. Therefore, for every one unit increase in female director in the audit committee, discretionary accruals equally increase by 0.051. This indicates that female directors in audit committee do not mitigate earnings management. The result is consistent with the expectation of the present study that predict a non-directional but significant association between female director in audit committee and earnings management. The finding does not support the resource dependence theory that supports gender diversity. The result supported the findings of previous studies (Carter *et al*., 2010; Ioualalen et al., 2015; Luo *et al*. , 2017; Marinova *et al*., 2010) .

The code of corporate governance 2011 was silent on the inclusion of women in the audit committee. That suggests that listed companies have the option to either include women or not. Although, there have been agitations by the women groups for the additional inclusion of women in both executive and boards appointment but only less than 10% on the average in the study sample are females in audit committees. It suggests that the proportion of women in the audit committee may be too small for the women to have a substantial impact.

This problem is not unique to Nigeria because studies have shown that women on corporate boards are few even in the developed countries (Burgess & Tharenou, 2002). In addition, Nigeria being a developing country, the educational gap between men and women is wide, with women at disadvantage (Hill & King, 1993; Ojobo, 2008). This might be one of the reasons why only few women get appointment into corporate boards. It might also affect their ability to contribute meaningfully during meetings (Ojobo, 2008).

In model 2 (prior to moderation effect of foreign ownership), the results disclosed an insignificant association between female director in audit committee and discretionary accruals. This indicates that female director in audit committee has no impact in discretionary accruals. Prior studies reported similar results (for example, Lincoln & Adedoyin, 2012; Sun *et a*l., 2011).

4.8.1.1.4 Audit Committee Meeting and Earnings Management

This study predicts significant relationship between audit committee meeting and earnings management. In model 1 as shown in Table 4.12, audit committee meeting (*ACMEET*) has a positive coefficient but insignificant association with discretionary accruals, indicating that audit committee meeting has no impact on earnings management. This result is inconsistent with the agency theory that internal monitoring can be improve through increase in the frequency of audit committee meeting. Previous studies established similar results (Abdul Rahman & Ali, 2006; Al-Rassas, 2015; Davidson *et al*., 2005; Soliman & Ragab, 2014). The code of corporate governance (2011) did not recommend minimum or maximum number of audit committee meeting. The code only recommends disclosure of the number of meetings held during the year and the attendance of individual directors at those meetings.

Similarly, Model 2 (prior to moderation of foreign ownership) showed a positive insignificant association (coefficient 0.164, t- statistics 1.20 and p- value 0.36). This suggests that audit committee meeting has no impact on discretionary accruals. The outcome supports the findings of Al-Rassas and Kamardin (2015).

4.8.1.1.5 Audit Committee Overlapping and Earnings Management

This study predicts a significant relationship between audit committee overlapping (*ACOL*) and discretionary accruals. The result in model 1 as depicted in Table 4.12 reveals coefficient of 0.02, t –statistics 1.39 and p-value 0.082. It indicates that a unit increase in audit committee overlapping (ACOL), discretionary accruals increase by 0.02 at 10% level. This is in agreement with the agency theory and busyness hypothesis that overlapping directors may face paucity of time that can hinder them from effective monitoring of the management (Ferris *et al*., 2003; Jiraporn *et al*., 2009). This result is in agreement with the previous studies (Jubb, 2000; Tanyi & Smith, 2014). The codes of corporate governance (2011) in Nigeria allowed overlapping but cautioned firms not to over load members. Therefore, lack of stringent policy on overlap in Nigerian code of corporate governance may be the reason for this result.

Model 2, Table 4.12 (prior to moderation of foreign ownership), (coefficient 0.029, t-statistics 2.30 and p-value 0.022), further indicates positive and significant association between audit committee overlapping and the discretionary accruals at 5% level. The result is consistent with previous studies (Abbott *et al*., 2004 ; Sáenz González & García-Meca, 2014).

4.8.1.1.6 External Auditors' Type and Earnings Management

External auditor's type (*EAT*) is expected to have either negative or positive significant relationship with discretionary accruals. Table 4.12 model 1 shows that for every single increase in external auditors' type, discretionary accruals decrease by 0.027 at 5% level (coefficient of -0.027, t-statistics -13.60 and P-value 0.050). The result supports the prediction of this study and agency theory. Agency theory put forward that to lessen agency cost high quality audit is needed. Some prior researchers opined that high quality audit depends on the size of the external auditor (Deangelo, 1981). Others such as Becker *et al*. (1998) and Defond and Jiambalvo (1993) argue that only the international audit firms (Big 4 auditors) can provide quality audit that can diminish earnings management due to their higher expertise and resource compared to their smaller audit firm counterpart. The finding of this study is consistent with findings of prior studies (for example, Al-Rassas & Kamardin, 2016; Alzoubi, 2016; Garven & Taylor; 2015; Houqe *et al*., 2017).

The result of model 2 (prior to moderation of foreign ownership) as depicted in model 2 of Table 4.12 shows insignificant relationship between the Big 4 and discretionary accruals. It means that audit by the Big 4 is not associated with discretionary accruals. Previous studies and reported similar result (for example, Khalil & Ozkan, 2016).

4.8.1.1.7 External Auditors' Independence and Earnings Management

The second external audit committee characteristic (*EAIND)* measured by audit tenure is predicted to have a positive and significant relationship with the discretionary accruals. Table 4.12 under model 1 depicts a significant positive relationship between external auditors' independence and discretionary accruals (coefficient 0.073, t-statistics 2.380 and p-value 0.07), thereby supporting hypothesis 8. Therefore, for every one unit increase in audit tenure, discretionary accruals increase by 0.073 at 10% significance level. This result means that long audit tenure decrease external auditors' independence and increase earnings management. There are different measurements of external auditors' independence. While some studies used non-audit services (NAS) to measure independence others used auditors' size or auditors' tenure. Due to dearth of data on NAS in the financial reports of listed companies in Nigeria, this study used audit tenure to measure external auditors' independence. Equally, this study predicts a shorter auditor - client period, by assuming that the independence of external auditor diminishes after 3 years with a client, which increase discretionary accruals adopted from (Geiger & Raghunandan, 2002). The result support agency theory that for auditing to reduce agency cost, the auditor must be independent. Past studies reported similar results (for example, Davis *et al*., 2002; Garcia-Blandon & Argiles, 2015). These studies establish that external auditors would agree to forfeit their independence to get a long audit period. The code of corporate governance (2011) recommends rotation of external auditor after every 10 years of continuous engagement to maintain their independence.

Model 2 (prior to moderation of foreign ownership) shows a coefficient of 0.434, t-statistics 1.89 and p-value 0.059. The result is in line with model 1 that for every one unit increases in audit tenure beyond three years, discretionary accruals increase by 0.434 at 10% significance. This is in agreement with the expectation of this study that predicts a significant positive relationship between the two variables.

4.8.1.1.8 Foreign Ownership and Earnings Management

The present study predicts a significant relationship between foreign ownership (*FO*) which is the moderating variable with the discretionary accruals. Table 4.12 (model 1) reveals that a single rise in foreign ownership leads to a reduction in discretionary accruals by 0.27 at 1% significance (coefficient -0.27, t-statistics -3.54 and P-value 0.000). That means FO in companies increase the monitoring capacity of the audit committee and reduces discretionary accruals. Similarly, Table 4.12 shows foreign ownership as moderator introduced in model 2 (prior to interaction) reveals a negative and significant association with discretionary accruals (coefficient -0.051, t-statistics -0.13 and p-value 0.095). This shows that foreign ownership is related negatively to discretionary accruals. It indicates lower discretionary accruals in companies with higher foreign ownership. The results in both models are consistent with resource dependence theory that foreign shareholders bring in experience and expertise from their relatively strong corporate governance countries for the benefit of local firms (Ho *et al*., 2011; Shu *et al*., 2014). It is also consistent with the agency theory as established by Ahmed and Iwasaki (2015) that foreign ownership improves monitoring, minimize agency costs, increase firm's value and mitigate both real and accrual earnings management. Prior studies established similar result (for example, Chung *et al*., 2004; Desender *et al*., 2014; Guo *et al*., 2015).

The code of corporate governance (2011) did not mention foreign ownership. It means there is no hard rule requesting public companies to have a mixture of foreign ownership in their capital structure. From the sample of this study, the companies with foreign investors range from minimum of zero to maximum of 88 %. This reveals that there are companies without foreign ownership and there are those with high foreign ownership. It confirms that the companies are free to allow foreign investment or not. The NIPC act allowed foreign investors to own up to 100% ownership in any company except in the oil and gas sector.

4.8.1.1.9 Firm Size and Earnings Management

On the control variables, firm size (*FSIZE*) in model 1 is found to be significant with a positive direction with the discretionary accruals (coefficient 0.203, t-statistics 2.77, p-value 0.000). This shows that discretionary accruals increase by 0.30 for every one unit increase in firm size. This result reveals that big firms engage more in earnings management. This result is consistent with the study by Habbash *et al*. (2014) and contradicts that of Juhmani (2017).

Similarly, model 2 (prior to interaction of foreign ownership) as shown in Table 4.12 indicates a similar result with model 1 (coefficient 0.195, t-statistics 2.69 and P-value 0.007). It indicates that discretionary accruals increase by 0.195 for every single unit increase in firm size. The positive relationship between FSIZE and discretionary accruals is significant at 10%. This result is in agreement with previous study (Dahlquist & Robertson, 2001).

4.8.1.1.10 Leverage and Earnings Management

Leverage (*LEV*) in model 1 reveals a significant positive association with discretionary accruals. It shows a coefficient 0.302, t-statistics 0.61 and p-value of 0.010. The result is consistent with the findings that highly leveraged firms manage earnings upward (An, Li, & Yu; 2016; Press & Weintrop, 1990). On the contrary, model 2 (prior to moderation of foreign ownership) depicts an insignificant association between leverage and discretionary accruals, meaning that leverage has no impact on discretionary accruals. The outcome is in conformity with the findings of Abdul Rahman and Ali (2006), and Waweru and Riro (2013).

4.8.1.1.11 Profitability and Earnings Management

Profitability (*PROF*) in model 1 in Table 4.12 reveals a significant and positive relationship to discretionary accruals (coefficient 0.148, t-statistics 2.50 and p-value 0.013). It means that discretionary accruals will increase by 0.148 if profitability increases by one unit. The result negates the assertion that profitable firms do not manage earnings. Some studies argue that profitable companies equally take advantage and further manage earnings upward to make their firm more attractive. This is similar to the findings by Sáenz González and García-Meca (2014) and Kothari *et al*.(2005). The possible reason for the variation in findings is differences in measurement. Some studies used ROA while others used ROE as an indicator of profitability. However, this study used proportion of interest bearing debt to equity.

Similarly, in model 2 (prior to moderation of foreign ownership) a significant relationship is established between profit status of firms and discretionary accruals (coefficient 0.351, t-statistics 1.75 and p-value 0.08). That suggests that profitable firms report lower earnings management than unprofitable ones.

4.8.1.1.12 Firm Growth and Earnings Management

Model 1 as depicted in Table 4.12 showed a positive and insignificant relationship between firm growth (*FGROW*) and discretionary accruals, indicating that firm growth has no impact on earnings management. This is consistent with the finding of Abdul Rahman and Ali (2006) and Johl *et al*. (2013). Model 2 also reveals an insignificant positive relationship between firm growth and discretionary accruals. The result does not confirm the assumption that earnings management is significantly associated with firm growth rate. The model 2 (prior to interaction of foreign ownership) is similar to that of model 1 indicating that firm growth has not impact on earnings management.

4.8.1.1.13 Moderating Effect of Foreign Ownership on the Association between Audit Committee Size and Discretionary Accruals (FO**ACSIZE*)

Extant studies have established varying results on the relationship between audit committee size and discretionary accruals. With the introduction of foreign ownership as a moderating variable, the present study predicts a significant relationship between the audit committee size and discretionary accruals. It also hypothesizes foreign ownership could moderate the association between *ACSIZE* and DAC. That is to have a stronger association between the two variables. As depicted in model 2 in Table 4.12 (coefficient -0.176, t-statistics -1.54 and p-value 0.040). It shows that one unit addition in the moderating variable (FO) in audit committee size leads to a decrease by 0.176 in DAC at 5% level.

It indicates that examining the association of ACSIZE with DAC in isolation of the interaction with FO, the association was negative at 10% level of significance. However, with the interaction of foreign ownership and audit committee size (FO* ACSIZE), the association remain negative but at 5% level. It could be stated that the effectiveness of audit committee in carrying out its oversight function may improve with the presence of foreign ownership. Therefore, hypothesis nine is supported. Figure 4.3 show that interaction of foreign ownership in *ACSIZE* leads to lower DAC. With the moderating variable, the association between the two variables is stronger.

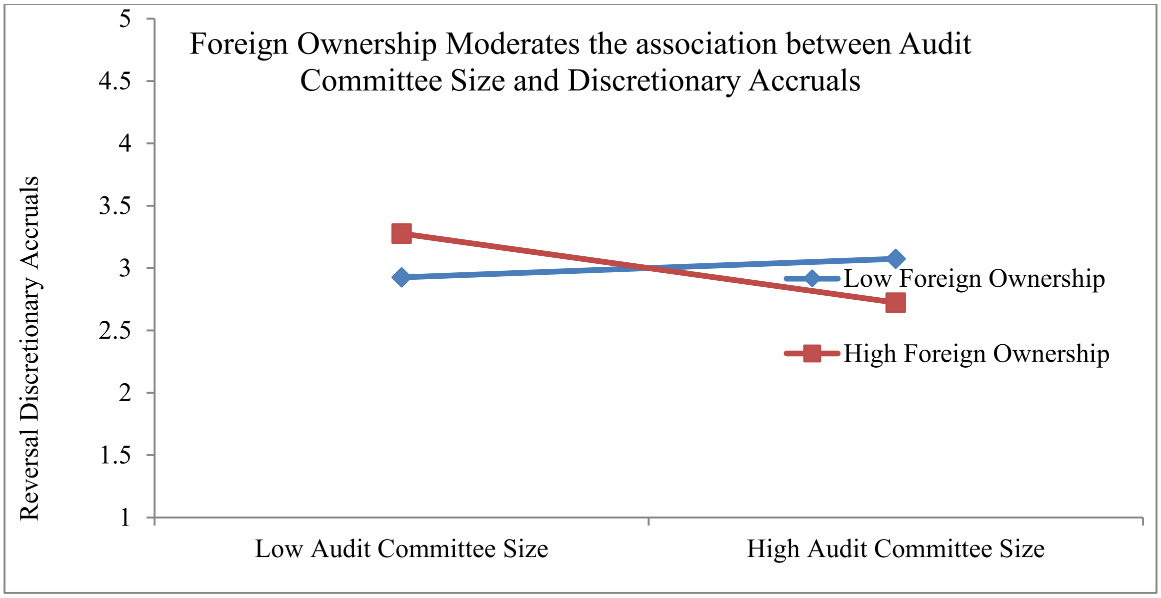

Figure 4.3: Moderating Effect of Foreign Ownership on ACSIZE – DAC

In Figure 4.3, the dependent variable (DAC) is plotted on Y-axis and the independent variable (audit committee size) on the X-axis. The moderating variable (foreign ownership) categorized into low and high at the center of the graph. The interpretation is that as audit committee size and foreign ownership increase (moving towards right), discretionary accruals reduces. On the other hand, as audit committee size and foreign ownership decrease (moving toward left), discretionary accruals increase. The inverse relationship means that the interaction of foreign ownership in audit committee size leads to lower discretionary accruals. Therefore, foreign ownership has moderates the association between audit committee size and earnings management. The foreign ownership makes the negative association between audit committee size and earnings management stronger.

4.8.1.1.14 Moderating Effect of Foreign Ownership on the Association between Audit Committee Independence and Discretionary Accruals (FO**ACIND*)

The association between *ACIND* and DAC has been established by many previous studies but without consensus. This study introduced foreign ownership (*FO*) to strengthen the association. It postulates that foreign ownership moderates the association between audit committee independence and discretionary accruals in order to make that association stronger. Thus, a significant negative association is expected.

The regression result in model two, Table 4.12 depicts (coefficient -0.052, t-statistics -1.83, and p-value 0.022) reveals that for every one unit rise in foreign ownership moderation in the *ACIND*, discretionary accruals decrease by -0.052 at 5% level. The presence of foreign owners in firms may increase the independence and monitoring capacity of audit committee significantly to mitigate earnings management. The result showed that the association between *ACIND* and DAC (FO*ACIND) becomes stronger with the moderating effect of foreign ownership. Figure 4.4 graphically depicts the effect of the interaction.

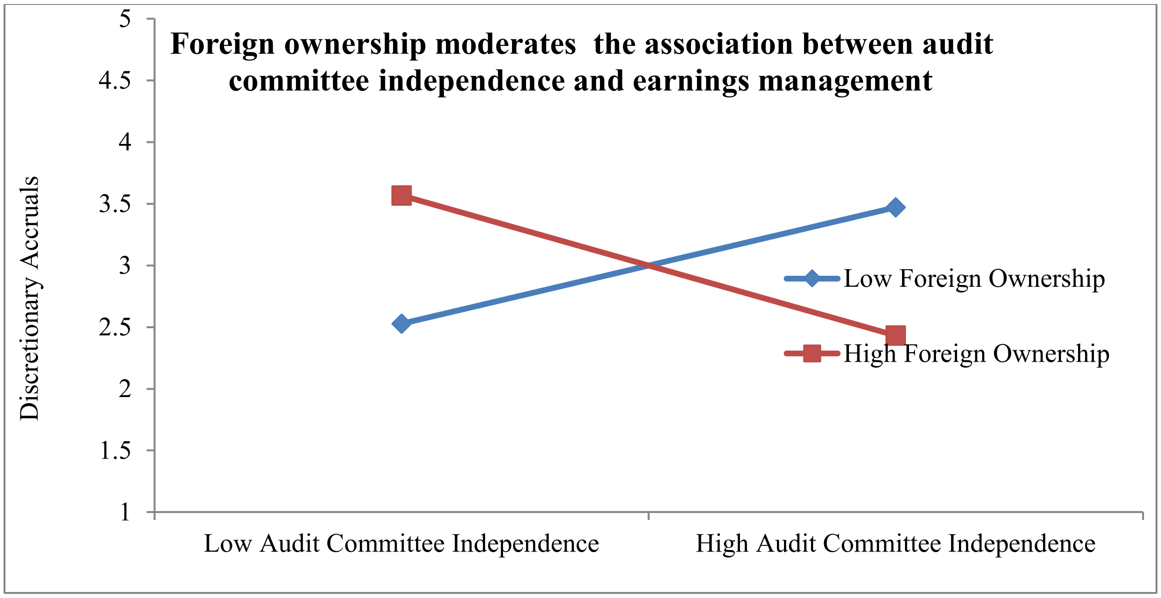

Figure 4.4 Moderating Effect of Foreign Ownership on ACIND - DAC

In Figure 4.4, the dependent variable (DAC) is plotted on Y-axis and the independent variable (audit committee independence) on the X-axis. The moderating variable (foreign ownership) categorized into high and low at the center of the graph. The interpretation is that as audit committee independence and foreign ownership increase (moving towards right), discretionary accruals reduces. Alternatively, discretionary accruals increase as audit committee independence and foreign ownership decrease (moving toward left). This means that the interaction of foreign ownership in audit committee independence leads to lower discretionary accruals. Therefore, foreign ownership has moderates the association between audit committee independence and earnings management.

4.8.1.1.15 Moderating Effect of Foreign Ownership on the Association between Female Director in Audit Committee and Discretionary Accruals (FO**FMDIRECT*)

The results of prior studies conflict each other on the association between female director in the audit committee and earnings management. This study introduced foreign ownership as a moderating variable in order to make the association between these variables stronger. Furthermore, the study hypothesizes the moderating role of foreign ownership on the association between female director and discretionary accruals (to make the association stronger).

In Table 4.12, the results of model 2 (coefficient 0.061, t-statistics 0.56 and p-value 0.577) reveals an insignificant and positive coefficient (FO*FMDIRECT) with discretionary accruals. Therefore, the result points that foreign ownership does not moderate between *FMDIRECT* and DAC. Hypothesis 12 is rejected. Similarly, the result is inconsistent with the RDT that female in the board or audit committee can bring additional expertise that can help the committee achieve its objective. Both the results of model 1 (positive and significant coefficient) and model 2 prior to interaction (positive and insignificant) do not show the impact of female director (even with foreign ownership interaction). As explained under model 1, the sample data of this study had very insignificant proportion (less than 10%) of women in the audit committee. It is difficult for such a scanty percentage to show meaningful result. In addition, few women in Nigeria possess the required skills and knowledge to be able to effectively make impact on board or audit committee (Ojobo, 2008) and foreign ownership fails to make a difference. Figure 4.5 graphically depicts the association between the two variables.

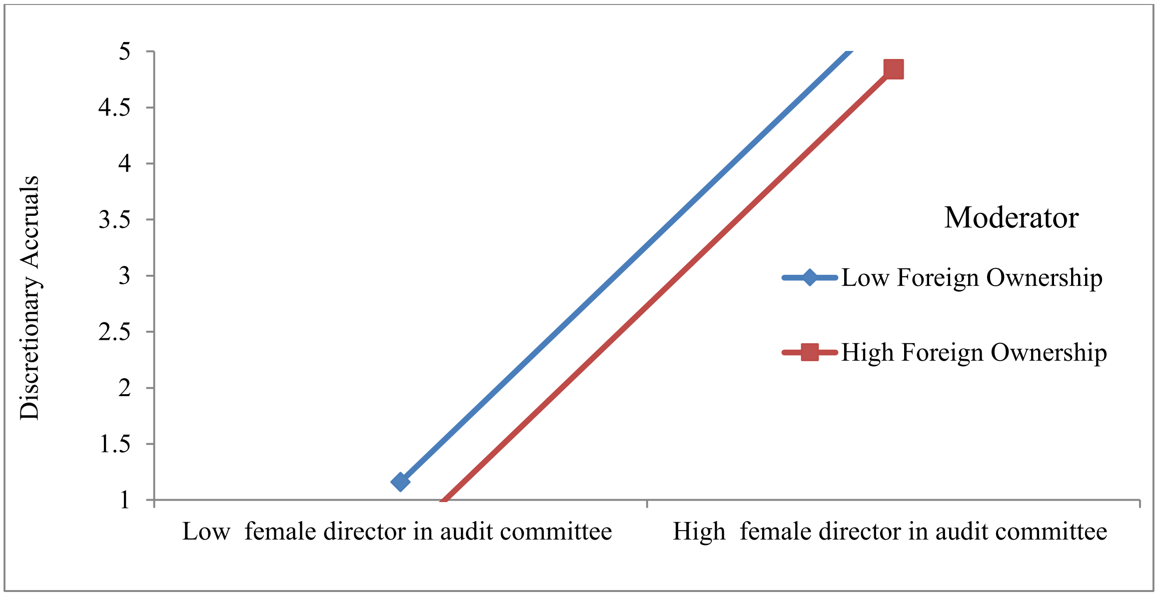

Figure 4.5 Moderating Effect of Foreign Ownership on FMDIRECT – DAC

In Figure 4.5, the dependent variable (DAC) is plotted on Y-axis and the independent variable (female director in audit committee) on the X-axis. The moderating variable (foreign ownership) classified into high and low at the center of the graph. The interpretation is that as female director in audit committee and foreign ownership increase (moving towards right-up), discretionary accruals equally increase. On the other hand, as female director in audit committee and foreign ownership decrease (moving toward left down), discretionary accruals decrease. This means that there is no interaction of foreign ownership in female director in audit committee. Therefore, foreign ownership failed to moderate the association between female director in audit committee and earnings management. Therefore, even with the presence of foreign ownership female representation in the audit committee does not lessen level of discretionary accruals.

4.8.1.1.16 Moderating Effect of Foreign Ownership on the Association between Audit Committee Meeting and Discretionary Accruals (FO**ACMEET*)

The findings by researchers on the association between audit committee meetings and discretionary accruals have been mixed. The present study introduces foreign ownership as a moderator to strengthen the association. Therefore, this study predicts a significant association between the variables. It also hypothesizes the moderating effect of foreign ownership on the association between audit committee meetings and discretionary accruals.

In Table 4.12, the results of model 2 (coefficient -0.049, t-statistics -0.75 and p-value 0.09) tells that a single rise in foreign ownership interaction in the audit committee meeting, discretionary accruals decrease by 0.049 at 10 % level. Comparing this result with the result of the association between ACMEET and DAC in model 1, shows that with the interaction of foreign ownership, the coefficient is now negative and significant. It discloses that foreign ownership moderates the association between audit committee meeting and discretionary accruals. The introduction of the moderator strengthens the weak association between *ACMEET* and DAC. It indicates that companies with foreign ownership, meets regularly and report lower discretionary accruals. Figure 4.6 depicts the association graphically:

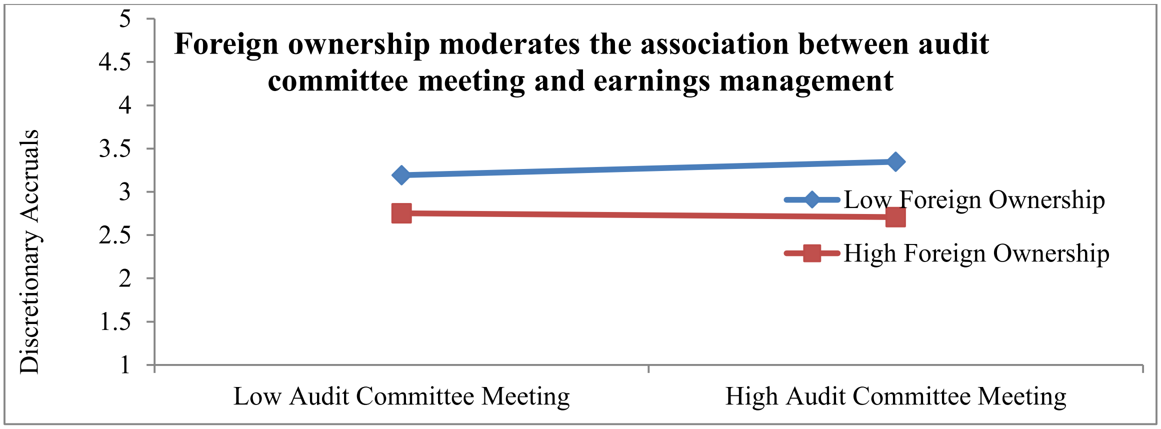

Figure 4.6 Moderating Effect of Foreign Ownership on ACMEET – DAC

In Figure 4.6, the dependent variable (DAC) is plotted on Y-axis and the independent variable (audit committee meeting) on the X-axis. The moderating variable (foreign ownership) classified into high and low at the center of the graph. The interpretation is that as audit committee meeting and foreign ownership increase (moving towards right), discretionary accruals decreases. On the other hand, as audit committee meeting and foreign ownership decrease (moving toward left), discretionary accruals increase. This means that the interaction of foreign ownership in audit committee meeting leads to lower discretionary accruals. Therefore, foreign ownership has moderates the association between audit committee meeting and earnings management. The association between audit committee meeting and discretionary accruals is now stronger.

4.8.1.1.17 Moderating Effect of Foreign Ownership on the Association between Audit Committee Overlapping and Discretionary Accruals (FO**ACOL*)

Despite the dearth of studies on audit committee overlapping, the result on its association with discretionary accruals is diverse (Mendez *et al*., 2015). This study predicts a significant association between audit committee overlapping and discretionary accruals. The study hypothesizes that foreign ownership significantly moderates the association between *ACOL* and DAC.

As revealed in Table 4.12, for every one unit increase in the moderation of FO in *ACOL*, DAC increases by 0.012 at 5% level (coefficient 0.012, t-statistics 0.13 and p-value 0.003). Comparing with the result of model 1 prior to interaction it indicates that with the interaction of foreign ownership (FO) in audit committee overlapping, the positive and significant association improves (10% to 5%). The result agrees with the busyness hypothesis that overlapping audit committee members become over-stretched, which could lead to lower monitoring of the management. The weak monitoring may lead to higher discretionary accruals. Figure 4.7 depicts the association graphically.

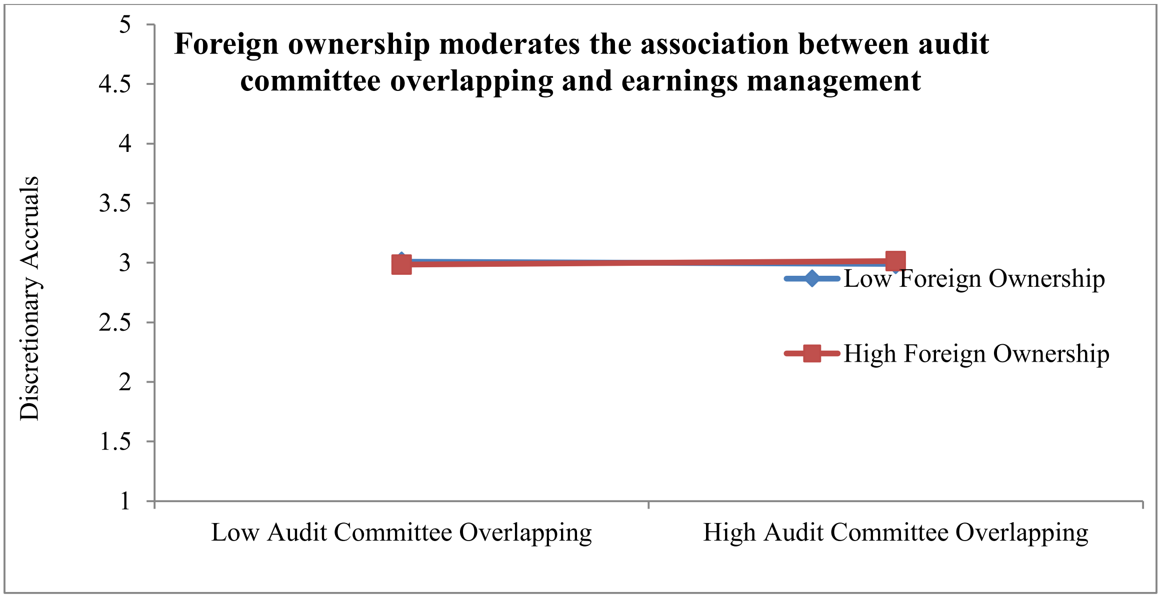

Figure 4.7 Moderating Effect of Foreign Ownership on ACOL - DAC

In the graphical presentation shown in Figure 4.7, the dependent variable (DAC) is plotted on Y-axis and the independent variable (audit committee overlapping) on the X-axis. The moderating variable (foreign ownership) classified into high and low at the center of the graph. The interpretation is that as audit committee overlapping and foreign ownership increase, (moving toward right), discretionary accruals decrease. Correspondingly, as audit committee overlapping and foreign ownership decrease (moving toward left), discretionary accruals increase. This means that the interaction of foreign ownership in audit committee overlapping leads to lower discretionary accruals. Therefore, foreign ownership has moderates the association between audit committee overlapping and earnings management. The negative association between audit committee overlapping and discretionary accruals is now stronger.

4.8.1.1.18 Moderating Effect of Foreign Ownership on the Association between External Auditors' Type and Discretionary Accruals (FO*EAT)

The findings on whether audit quality measured by the Big 4 mitigates earning management are varied. This study introduced foreign ownership as a moderator to strengthen the association between the variables. The hypothesis of the study is that foreign ownership significantly moderates the association between *EAT* and DAC.

The regression result in Table 4.12 shows that for every single rise in foreign ownership in *EAT*, 0.047 of discretionary accruals decreases at 1 % level. Prior to the interaction of foreign ownership (FO) in external auditors' type (model 1), the coefficient is negative at 5%. The introduction of the moderator further strengthen the negative association between *EAT* and DAC to 1%. This supports the view that Big 4 external auditors provide quality audit that lessen agency cost, which may lead to lower discretionary accrual. Therefore, foreign ownership has moderates the association between external auditors' type and earnings management. The association between external auditors' type and discretionary accruals is now stronger. The graphical association after the interaction is shown in Figure 4.8

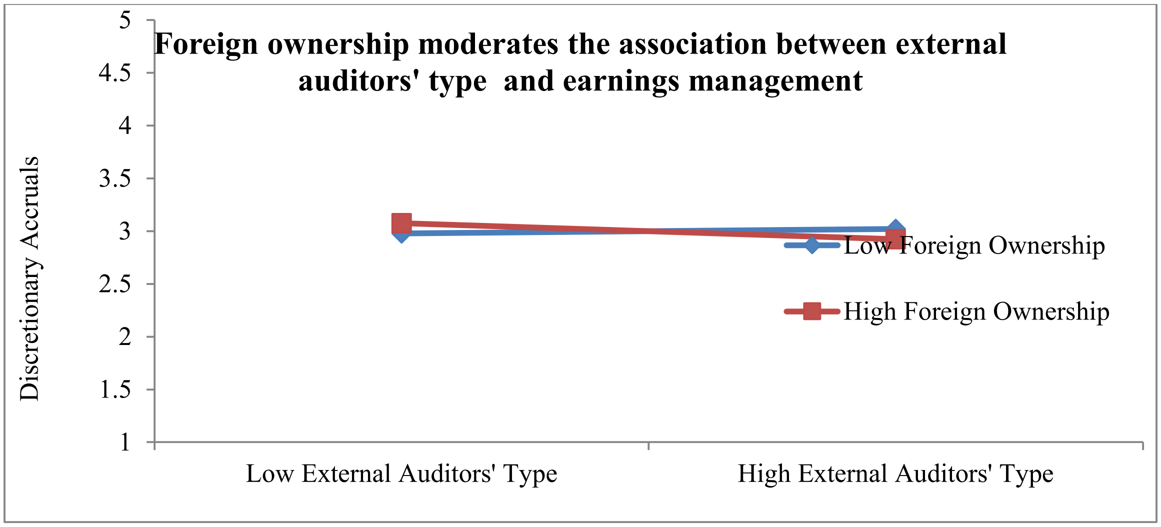

Figure 4.8 Moderating Effect of Foreign Ownership on EAT - DAC

As shown graphically in Figure 4.8, the dependent variable (DAC) is plotted on Y-axis and the independent variable (external auditors' type) on the X-axis. The moderating variable (foreign ownership) classified into high and low at the center of the graph. The explanation is that as external auditors' type and foreign ownership increase (moving towards right), discretionary accruals decrease. On the other hand, as external auditors' type and foreign ownership decrease (moving toward left), discretionary accruals increase. This suggests that the interaction of foreign ownership in external auditors' type leads to lower discretionary accruals.

4.8.1.1.19 Moderating Effect of Foreign Ownership on the Association between External Auditors' Independence and Discretionary Accruals (FO*EAIND)

The results by previous studies on the association between independence of external auditors and discretionary accruals varied. This study introduced foreign ownership as a moderator to strengthen the association. This study hypothesize that foreign ownership significantly moderates the positive association between *EAIND* and DAC. Similarly, Table 4.12 depicts negative but insignificant association after the interaction of the moderating variable, which means foreign ownership does not moderate the association between *EAIND* and DAC. The association between external auditors' independence and earnings management is stronger before the interaction (model 1). Figure 4.9 depicts the result graphically:

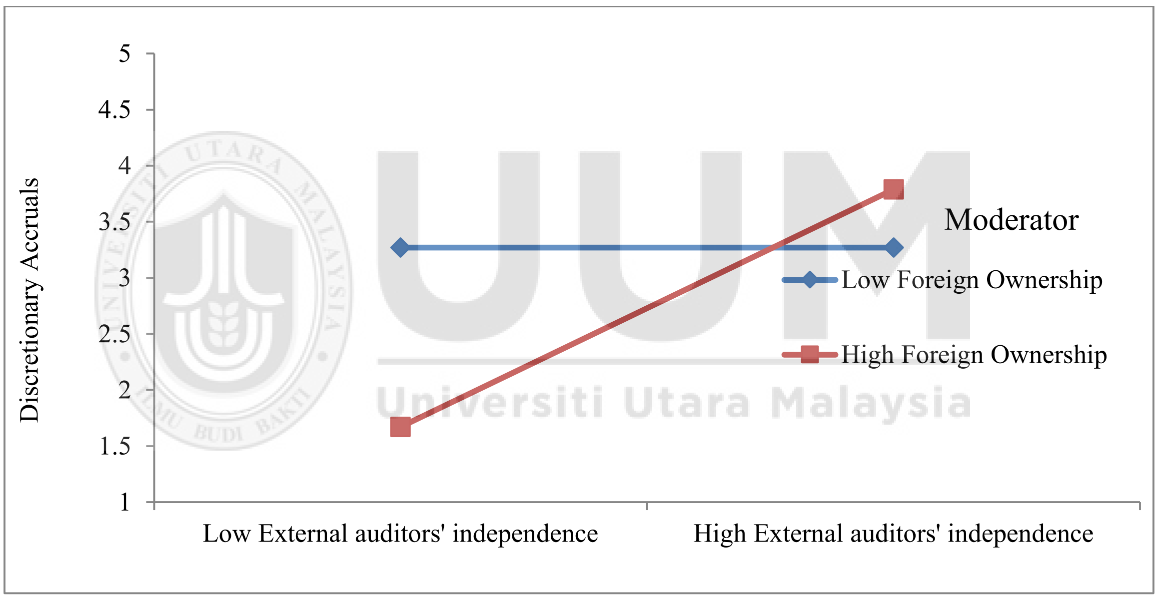

Figure 4.9 Moderating Effect of Foreign Ownership on EAIND - DAC

As shown graphically in Figure 4.9, the dependent variable (DAC) is plotted on Y-axis and the independent variable (external auditors' independence) on the X-axis. The moderating variable (foreign ownership) classified into high and low at the center of the graph. The explanation is that as external auditors' independence and foreign ownership increase (moving towards right-up), discretionary accruals increase. On the other hand, as external auditors' independence and foreign ownership decrease (moving toward left), discretionary accruals decrease. This suggests absence of interaction between foreign ownership in external audit independence. Therefore, foreign ownership failed to moderate the association between external auditors' independence and earnings management.

4.8.1.2 Interaction Changes

Due to the introduction of foreign ownership as a variable to moderate the association between *ACSIZE*, *ACIND*, *FMDIRECT*, *ACMEET*, *ACOL*, *EAT* and *EAIND* and discretionary accruals, Table 4.12 shows the effect of variation in model 1. The R^2 rises to 69.7% from 63.6% given a change of 6.1%. This may be due to the interaction of foreign ownership in model 2.

Table 4.13
Effect of Interaction Change for the Moderation

Models	R- Square	Adj R^2	Changes in R^2	Sig
Model One	0.636	0.627	0	0.000
Model Two	0.697	0.705	0.061	0.000

The finding in model 1 as shown in Table 4.13 indicates how effective audit committee mitigates earnings management supporting both the agency theory and *RDT*. Accordingly, the effect of moderator introduced in model 2 depicts added robustness of the model to lessen discretionary accrual at 1% level of significance as reflected in Table 4.13.

4.9 Robustness Checks Analysis

To support the outcomes of this study, a robustness check is carried-out. The study conducted a regression for split sample for pre-and post-corporate governance code. Secondly, a hierarchical regression is conducted that reveals how each set of variables contribute in mitigating earnings management. Thirdly, is the test for positive and negative discretionary accruals. Fourthly, is the alternative measurement of discretionary accruals. Finally, is the effect of industry on discretionary accruals.

4.9.1 Split Sample for Pre- and Post-Corporate Governance 2011

To verify the findings on the extent of discretionary accruals between pre and post revised corporate governance code, a regression for split sample is conducted on the individual independent variables. Table 4.18 shows regression result for pre-and post-corporate governance code. The R-squared for the pre-period is 29.5% indicating that the independent variables explained the model by 29.5%. The F-statistics is 45.53 at 1% level of significance. For the post-period, R-squared is 32% with F-statistics is 30.16 at 1% level of significance. This shows a disparity in the level of significance of the independent variables between the two periods. Audit committee overlapping (ACOL) is the only variable that negatively and significantly related to discretionary accruals. It indicates that audit committee overlapping can reduce level of earnings management. However, audit committee size (ACSIZE), female director in audit committee (FMDIRECT) and external auditor's independence (EAIND) positively and significantly affects discretionary accruals. Firm size (FSIZE) also positively affects discretionary accruals.

In the post-period, audit committee size (ACSIZE), audit committee independence (ACIND) and external auditors' type (EAT) are negatively and significantly related to discretionary accruals. This indicates that these variables could reduce earnings management. It also shows an improvement in these variables after the review of the code. In contrast, audit committee meeting (ACMEET) positively and significantly affects discretionary accruals, indicating that frequency of audit committee meeting may increase earnings management. The result depicts that audit committee overlapping (ACOL), female director in audit committee (FMDIRECT) and external auditor's independence (EAIND) have no impact on discretionary accruals. On the control variables, both leverage (LEV) and profitability (PROF) are significantly related to discretionary accruals.

The result is consistent with the earlier findings that the revised corporate governance code (2011) is more effective in mitigating earnings management. This is because the post-period has shown improvement in most of the variables except audit committee meeting (ACMEET). However, audit committee overlapping (ACOL), female director in audit committee (FMDIRECT) and external auditor's independence (EAIND) have lost their significance in the post-period. The trend in the split sample regression is similar to the full sample (model 1) depicted in Table 4.12.

4.9.2 Analyses of Contribution to the Model

In order to identify moderating effect, hierarchical regression is commonly used technique (Auh & Menguc, 2005; Baron & Kenny, 1886). According to Baron and Kenny (1986), hierarchical regression is an appropriate method to determine moderating effect of quantitative variable on the association between other quantitative variables. The process is to firstly create the interaction terms by multiplying the explanatory variable with the moderator variable (West, Aiken & Krull, 1996). According to Baron and Kenny (1986), four steps are followed in entering the variables in the regression equation; first is the control variables; second are the independent variables; third is the moderating variable; and fourth is the interaction terms of the explanatory variables and moderating variables. The results of the four steps are shown Table 4.14

Table 4.14
General Model Section Analyses

		Step One		Step Two		Step Three		Step Four	
	Sign	**Coefficient**	**t- stat.**	**Coefficient**	**t- stat.**	**Coefficient**	**t- stat.**	**Coefficient**	**t- stat.**
Constant	±	-0.200***	-3.36	-2.007	-3.05	-1.97	-2.95	-2.007***	-3.05
FSIZE	±	0.203***	2.77	0.203***	2.770	0.203***	2.770	0.195*	2.69
LEV	±	0.302*	0.61	0.302*	0.61	0.302*	0.61	-0.002*	-0.63
PROF	±	0.148*	2.50	0.148*	2.50	0.148*	2.50	0.351	1.75
FGROW	±	0.250	0.850	0.250	0.850	0.250	0.850	1.350	1.01
ACSIZE	±			-0.102*	-1.65	-0.102*	-1.65	0.029	0.51
ACIND	-			-0.048*	-1.51	-0.048*	-1.51	0.151	0.58
FMDIRECT	±			0.051**	1.830	0.051**	1.830	-0.062	-0.19
ACMEET	±			0.027	9.680	0.027	9.680	0.164	1.20
ACOL	±			0.002	1.390	0.002	1.390	0.029*	2.30
EAT	±			-0.027**	-13.60	-0.027**	-3.60	-0.064*	-0.98
EAIND	+			0.073*	2.380	0.073*	2.380	0.434	1.89
FO	–					-0.051*	-0.13	-0.051*	-0.13

Table 4.14 (Continued)

	Sign	Step One Coefficient	Step One t- stat.	Step Two Coefficient	Step Two t- stat.	Step Three Coefficient	Step Three t- stat.	Step Four Coefficient	Step Four t- stat.
FO**ACSIZE*	±							-0.06**	-6.2
FO**ACIND*	±							-0.85**	-1.96
FO**FMDIRECT*	±							0	-1.53
FO**ACMEET*	±							-0.4	-2.2
FO**ACOL*	±							-0.24*	-9.58
FO*EAT	±							-0.13***	-4.09
FO*EAIND	±							0.53	1.27
R- Squared			0.525		0.636		0.64		0.697
Adjusted R^2			0.5385		0.627		0.63		0.705
F-value			79.030***		73.26***		73.26***		68.49***

***, **,* indicate level of significance at 1%, 5% and 10% respectively. The p-values show the result at two-tailed. DAC is discretionary accruals , ACSIZE is audit committee size, ACIND is audit committee independence, ACEXPERT is audit committee expert, FMDIRECT is the female director in the audit committee, ACMEET is audit committee meeting, ACOL is audit committee overlapping, EAT is external auditors' type, EAIND is external auditors' independence, FO is foreign ownership, FSIZE is firm size, LEV is leverage, PROF is profitability, FGROW is firm growth, FO*ACSIZE is the interaction effect of foreign ownership in audit committee size, FO*ACIND is the interaction effect of foreign ownership in audit committee independence, FO*FMDIRECT is the interaction effect of foreign ownership in female director in audit committee, FO*ACMEET is the interaction effect of foreign ownership in audit committee meeting, FO*ACOL is the interaction effect of foreign ownership in audit committee overlapping, FO*EAT is the interaction effect of foreign ownership in external auditors' type, FO*EAINDT is the interaction effect of foreign ownership in external auditors' independence

Table 4.14 shows that model 1 (step 1) with R^2 52.50%, F-value is 79.030 significant at 1%. Only control variables are regressed in this step. This indicates that the control variables explained the model by 52.5%.

In model 2 (Step 2) in Table 4.14, by adding the independent variables, the R^2 (model fitness) increased to 63.6%. This implies that the change (increase) in R^2 (0.111 or 11.1%) is explained by the independent variables.

Model 3 (step 3) as depicted in Table 4.14 also show that by adding foreign ownership, the R^2 (model fitness) increased by 4%. The result implies that foreign ownership (FO) has an effect on discretionary accruals.

In model 4 (final step) as shown in Table 4.14, when the interaction was included, the R^2 (model fitness) increased to 69.7%. The change in of R^2 5.7% indicates that foreign ownership (interaction) affect the association between audit committee and external audit characteristics and discretionary accruals.

4.9.3 Discretionary Accruals Direction Analysis

To find out the trend of the discretionary accruals, this section segregates the positive (income-increasing earnings management) and negative accruals (income-decreasing earnings management). According to Minitab 17 (2010), a two-sample t-test is employed to compare the positive and negative accruals. This test is used to compare not only the means of each group but to know whether the difference in the mean is statistically significant. It can be applied to two samples with different population size especially if the distribution of the data is normal. Minitab 17 (2010) further states that when the data distribution is not normal, Mann-Whitney U test can be considered instead. Table 4.15 depicts the result of the 2 sampled t-test:

Table 4.15
DAC Analysis based on Positive or Negative Accruals

Variable	Obs	Means	Std.Err	Std Dev.	95% Conf.	Interval
Positive DAC	298	0.710425	0.03428	0.590777	0.6429609	0.7778891
Negative DAC	260	-1.12478	0.165877	2.674683	-1.451419	-0.798141
Combined	558	-0.14622	0.088455	2.087604	-0.3199697	0.0275225
Diff		1.835205	0.159448		1.522009	2.148401

diff = mean (positive) – mean (negative)		t = 11.5097
Ho: diff = 0		degree of freedom=556
Ha: diff < 0	Ha: diff != 0	Ha: diff > 0
Pr(T < t) = 1.0000	Pr(|T| > |t|) = 0.0000	Pr(T > t) = 0.0000

Table 4.15 shows a mean difference in discretionary accruals between positive (298 firm-year observations) and negative (260 firm-year observations) discretionary accruals of 1.835205 with 95% confidence intervals of 1.522009 to 2.148401. The result also shows t-value of 11.5097 the degree of freedom of 556 and statistical significance (2-tailed p-value) of the paired t-test (Pr **(**|T| **>** |t|**)** under Ha: diff> 0), which is 0.0000. As the p-value is less than 0.05 (p<0.05), it can be interpreted that there is a statistically significant difference between the positive and negative discretionary accruals. In other words, the difference of discretionary accruals between the positive and negative discretionary accruals is not equal to zero. Simply put, the mean of income-increasing discretionary accruals exceeds that of

income-decreasing discretionary accruals in. This is line with focus of this study that earnings management in Nigeria is more of income increasing.

4.9.3.1 Alternative Measurement of Earnings Management

To compare the results obtained using modified Jones model by Dechow *et al*. (1995), another model called extended modified Jones model by Yoon, Miller and Jiraporn (2006) is used. The model by Yoon *et al*. (2006) proposes that the total accruals are associated with:

1) variation in the cash revenue/sales
2) change of cash expenses and non-cash expenses of depreciation expenses
3) retirement benefits expenses

Yoon et al. (2006) used the following model to calculate the total accruals:

$TA_t/REV_t = \beta_o + \beta 1\ (\Delta REV_t - \Delta RECt)/\ REV_t + \beta 2\ (\Delta EXP_t - \Delta PAY_t)\ /\ REV_t + \beta 3\ (EP_t + RET_t)\ /\ REV_t + e_t$

Where:

ΔEXP = change in sum of cost of goods sold and selling and general administrative expenses excluding non-cash expenses.

ΔPAY = change in accounts payable

DEP = depreciation expenses

RET = retirement benefits expenses

E_t = error term

Discretionary accruals, which represent earnings management (both income increasing and income decreasing), are accruals minus non-discretionary accruals for each observation as follows:

$DAC_t = TA_t / REV_t - [\beta_0 + \beta_1 (\Delta REV_t - \Delta REC_t) / REVt + \beta 2 (\Delta EXP_t - \Delta PAY_t) / REV_t + \beta 3(DEP_t + RET_t) / REV_t]$

Table 4.16 shows the results for the modified Jones model by Dechow *et al*. (1995) and the extended modified Jones model by Yoon et *al*. (2006).

Table 4.16
Comparison of Different Models

		Modified Jones Model (1995)			**Extended Modified Jones Model (2006)**		
Variables	Sign	Coeff.	t-statistics	P-value	Coeff.	t-statistics	P-value
ACSIZE	±	-0.102	-1.65	0.09*	0.211	1.52	0.41
ACIND	–	-0.048	-1.51	0.068*	-0.023	-0.09	0.07*
FMDIRECT	±	0.051	1.83	0.042**	-.001	-0.021	0.27
ACMEET	±	0.027	9.68	0.599	-.139	-1.25	0.06*
ACOL	±	0.002	1.39	0.082*	0.213	1.04	0.62
EAT	±	-0.027	-13.6	0.050**	-.105	-0.06	0.58
EAIND	+	0.073	2.38	0.07*	0.174	0.22	0.00***
FSIZE	±	0.203	2.77	0.00***	0.051	0.39	0.05*
LEV	±	0.302	0.61	0.010*	-0.12	0.99	0.72
PROF	±	0.148	2.5	0.013*	0.081	1.11	0.04*
FGROW	±	0.250	0.85	0.394	0.004	0.63	0.08*
Constant	±	-2.20	-3.36	0.000***	-4.61	-11.57	0.000***
R- Squared			0.636			0.589	
Adj R²			0.627			0.576	
F-statistics			73.26***			69.55***	
P-value			0.000***			0.000***	

N = 558**. *****, ****, *** is significant at 1%, 5% and 10%, respectively. The p-values show the result at two-tailed. Note: Yoon et al. (2006) measure discretionary accruals $DAC_t = TA_t / REV_t - [\beta_0 + \beta_1 (\Delta REV_t - \Delta REC_t) / REVt + \beta 2 (\Delta EXP_t - \Delta PAY_t) / REV_t + \beta 3(DEP_t + RET_t) / REV_t]$, ACSIZE is audit committee size, ACIND is audit committee independence, FMDIRECT is female director in audit committee, ACMEET is audit committee meeting, ACOL is audit committee overlapping, EAT is external auditors' type, EAIND is external auditors' independence

Table 4.16 compares the extended modified Jones model (2006) with the modified Jones model (1995). The R^2 of the extended modified Jones model is 58.9%, F- statistics of 69.55 at 1% significant. These are lower than R^2 63.6%, F-statistics of 73.26 at 1% significant obtained in modified Jones model (1995). This shows that modified Jones model (1995) is fit for this study. Absolute value of discretionary accruals is used in both the two models. On the individual variables, the modified Jones model (1995) depicts more significant results than the extended modified model (2006).

4.9.4 Effect of Industry Category

Analyses according to sector are carried out in order to find out if the results of this study would change due to industry categorization. Section 4.4.2 of this study showed that conglomerate sector has the least discretionary accruals. A dummy variable is used to measure that industry. It takes the value of "1" if the firm is categorized under conglomerate industry, and "0" otherwise. This study used the multiple regression models below to assess the level of the effect on each industry variable on the discretionary accruals.

$DAC_{it} = \beta_o + \beta_1(ACSIZE)_{it} + \beta_2(ACIND)_{it} + \beta 3(FMDIRECT)_{it} + \beta_4(ACMEET)_{it} + \beta_5(ACOL)_{it} + \beta_6(EAT)_{it} + \beta_7(EAIND)_{it} + \beta_8(FO)_{it} + \beta_9(FSIZE)_{it} + \beta_{10}(LEV)_{it} + \beta_{11}(PROF)_{it} + \beta_{12}(FGROW)_{it} + \beta_{13}(INDUSTRY\_agrc)_{it} + \beta_{14}(INDUSTRY\_cong)_{it}$ $\beta_{15}(INDUSTRY\_cons)_{it} + \beta_{16}(INDUSTRY\_cog)_{it} + \beta_{17}(INDUSTRY\_hcr)_{it} +$

$+\beta_{18}(INDUSTRY\_ict)_{it} + \beta 19(INDUSTRY\_ing)_{it} + \beta 20(INDUSTRY\_nrc)_{it} + \beta_{21}(INDUSTRY\_oag)_{it} + \beta_{22}(INDUSTRY\_srv)_{it} + \mu_{it}$

Where:

INDUSTRY_agrc stands for the agriculture industry, IDUSTRY_cons stands for construction and estate industry, IDUSTRY_cog stands for consumer goods industry, IDUSTRY_hcr stands for healthcare, IDUSTRY_ict stands for information technology industry, IDUSTRY_ing stands for industrial goods, IDUSTRY_nrc stands for natural resources, IDUSTRY_oag stands for oil and gas industry and IDUSTRY_srv stands for services industry.

Table 4.17 depicts that R- squared is 62.2%, F-statistics of 48.11 and level of significance is 1%. All the nine industries showed a negative coefficient but none has a significant association with discretionary accruals. This means that the type of industry has no effect on the result of this study.

Table 4.17
General Model with Industry Effect

Variables	sign	Coeff.	t-statistics	P-value
ACSIZE	±	-0.102	-1.65	0.09*
ACIND	–	-0.047	-1.51	0.068*
FMDIRECT	±	0.050	1.83	0.042**
ACMEET	±	0.027	9.68	0.599
ACOL	±	0.002	1.39	0.082*
EAT	±	-0.026	-13.6	0.050**
EAIND	+	0.073	2.38	0.070*
FSIZE	±	0.203	2.77	0.000***
LEV	±	0.302	0.61	0.010*
PROF	±	0.148	2.5	0.013*
FGROW	±	0.350	0.85	0.394
INDUSTRY_AGRC	–	-1.172	-0.920	0.360
INDUSTRY_CONS	–	-1.128	-0.970	0.337
INDUSTRY_COG	–	-0.813	-0.680	0.499
INDUSTRY_HCR	–	-1.649	-1.320	0.186
INDUSTRY_ICT	–	-1.595	-1.280	0.196
INDUSTRY_ING	–	-1.792	-1.410	0.159
INDUSTRY_NCR	–	-2.077	-1.440	0.113
INDUSTRY_OAG	–	-0.923	-0.630	0.469
INDUSTRY_SRV	–	-1.611	-1.260	0.208
Constant	±	-0.802	-0.60	0.000***
R-squared			0.622	
Adj R- Squared			0.613	
F-value			48.11***	

N = 558**. ***, **, *** is significant at 1, 5 and 10 percent respectively.

4.10 Summary

The chapter presents the findings, interpretation and discussions of this study. It begins with introduction, sample proportion of the study and estimation of discretionary accruals. The chapter continues with descriptive statistics, estimation according to industry, comparison between 2003 and 2011 codes, statistical assumptions and panel data analysis. The chapter ends with multivariate analyses.

In conclusion, the study carried out additional tests to ensure that the finding of the study is robust. It includes a hierarchical regression of the models, discretionary accruals direction analyses, alternative measurement of earnings management, effect of industry and split sample for pre-and post-corporate governance code.

CHAPTER FIVE

DISCUSSION, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter provides an overview of the research and summary of findings. Equally, it discusses the practical and theoretical significance of the study, limitations of the research, conclusion and recommendations.

5.2 Recap of the Study

The main aim of this study is to find out a relationship between audit committee and external audit characteristics and earnings management. Secondly, is to examine the moderating effect of foreign ownership on the association between audit committee and external audit characteristics and earnings management. Thirdly, is to find out the extent of earnings management before and after the revision of corporate governance code. Earnings management has been studied extensively in the past due to its devastating effect that led to collapse of so many big organizations in both developed and developing countries. Researchers and regulators recommend good corporate governance including having an effective audit committee and quality external audit in Nigeria. The initial code of corporate governance introduced in 2003 aimed at strengthening corporate governance mechanisms, which was revised in 2011to make it more effective.

This study extensively reviewed findings of prior studies on how audit committee and external audit characteristics could mitigate earnings management. However, the findings of the prior researches have been mixed. This study examined a sample of 93 publicly listed companies from 2009 to 2014 in Nigerian Stock Exchange (NSE). The analysis was based on balance panel dataset. Therefore, this study extends the literature by considering how foreign ownership in firms moderates the association between the audit committee and external audit characteristics and earnings management. The study used modified Jones model to measures earnings management. Similarly, audit committee and external audit characteristics were discussed from the perspective of agency theory and RDT.

5.3 Summary of the Research Results

This study attempts to answer four research questions. The questions were:

1) What was the extent of earnings management before and after the revised code of corporate governance 2011?

2) Did audit committee characteristics (size, expertise, female director in audit committee, independence, activity level and overlapping) significantly affect earnings management?

3) Did external audit characteristics (external auditors' type and external auditors' independence) significantly affect earnings management?

4) Did foreign ownership significantly moderate the association between audit committee and external audit characteristics and earnings management?

To answer RQ 1 on the extent of earnings management before and after the revision of corporate governance code (2011), this study employed a paired-sample t-test and compares if the means is different from zero. The result of the paired-sample t-test showed that the level of earnings management was higher before the revision.

To answer research questions (RQ) 2-4, this research employed multiple regressions to assess individual variables in line with either the agency, *RDT* or a combination of the theories. Accordingly, hypotheses both directional and non-directional were articulated for the audit committee and external audit characteristics as well as moderating effect of foreign ownership on the association between the individual variables and earnings management. The results show that the model was well specified and significant by the independent variables as discussed below:

Six hypotheses (1-6) were developed to answer RQ2. This study predicts significant relationship between audit committee size and earnings management. This study finds negative and significant relationship between audit committee size and earnings management supporting both the RDT and agency theory. The argument is that bigger audit committee size reduces earnings management. A firm that requires many experienced directors from the environment capable of providing the needed expertise that could effectively monitor the management should have a big audit committee enough to accommodate the number. An increased monitoring of the management could lead to lower earnings management. The result also concurs with the finding of Juhmani (2017). The revised corporate governance code (2011) in Nigeria allows companies to have audit committee size that suite their nature, size and peculiarities.

This study predicts negative and significant relationship between audit committee independence and earnings management. This study finds negative and significant relationship between audit committee independence and earnings management in support of the agency theory. Therefore, as the independence of the audit committee increases through inclusion of more NEDs, the monitoring capacity of the committee also increases. This invariably reduces the chances of the managers to manage earnings. Garven and Taylor (2015) also established significant negative relationship between audit committee independence and discretionary accruals. No specific measurement of audit committee independence was provided in the Nigerian revised corporate governance code (2011). This study used proportion of NEDs in the audit committee to measure the committee's independence.

This study predicts significant relationship between female director in audit committee and earnings management. This study finds a positive and significant relationship between female director in an audit committee and earnings management confirming the non-directional hypotheses. However, the result contradicts the RDT that argues in favor of audit committee diversity. This finding corroborates the finding of Ioualalen *et al*. (2015). Companies in Nigeria have freedom to either have a gender-balanced audit committee or not because the corporate governance code (2011) does not provide for that.

Audit committee expertise was dropped after the descriptive analysis showed absence of variation between expectations as per the corporate governance code (2011) and the actual based on the financial reports of the companies in the sample data. The result of the descriptive analysis revealed full compliance with the code.

This study predicts significant relationship between audit committee meeting and earnings management. This study finds positive but insignificant association. It specifies audit committee meeting has no impact on earnings management. This is contrary to the hypothesis of the study and agency theory. The result is consistent with some previous studies (for example, Al-Rassas, 2015; Soliman & Ragab, 2014). Corporate governance code in Nigeria did not specify the number of meeting to be held by public companies.

This study predicts significant relationship between audit committee overlapping and earnings management. This study finds positive and significant relationship between audit committee overlapping and earnings management, which is consistent with the prediction of the study. The result supports the agency theory and busyness hypothesis that overlapping members may face paucity of time, which may adversely affect their monitoring role. That eventually increases the propensity of earnings management by the managers. The result is in consistent with the finding of Tanyi and Smith (2014). The codes of corporate governance (2011) in Nigeria allowed overlapping but warned firms not to over load members. Therefore, there is lack of stringent policy or recommendation on overlap in the Nigerian code of corporate governance (2011).

In addition, two hypotheses (7-8) were developed to answer RQ 3 on external audit characteristics. Accordingly, this study predicts a significant relationship between external auditors' type, which measures quality of audit, and earnings management. This study finds that external auditors' type (proxied by the Big 4 audit firm) is negative and significantly associated to earnings management. The result is consistent with the agency theory that quality audit lessens agency cost. The finding is consistent with the findings of previous studies (Garven & Taylor, 2015; Houqe *et al*., 2017). The Nigerian corporate governance did not recommend a particular category of auditor to be engaged.

This study predicts a positive and significant relationship between external auditors' independence (using audit tenure) and earnings management. This study finds positive and significant association between the two variables. This is in agreement with prediction of the study and agency theory. The agency theory put forward that for external audit to minimize agency cost, the independence of the auditor is necessary. Corporate governance code (2011) in Nigeria provides for the mandatory rotation of external auditors after ten years and reengagement after seven years to ensure independence of external auditors.

Furthermore, eight hypotheses (9-16) were developed to answer RQ 4 on the moderating role on foreign ownership on the association between audit committee and external audit characteristics. These findings are discussed below:

The interacting effect of foreign ownership between audit committee size and earnings management reveals a significant negative association consistent with the prediction of this study. The introduction of foreign ownership as a moderator is justified because the level of significance between audit committee size and earnings management has slightly improved from 10% level (prior to the interaction) to 5% (after interaction). The result depicts a stronger relationship. Therefore, large-sized audit committee is capable of reducing earnings management especially with the presence of foreign ownership.

Again, this study anticipates a significant moderating effect of foreign ownership on the association between audit committee independence and earnings management. The result of this study agreed with the expectation that firms with foreign ownership are likely to have more independent audit committee (with high NEDs) that can control mangers effectively. Therefore, the association between audit committee independence and earnings management became stronger after interaction of foreign ownership (10% to 5%).

Equally, the moderating effect of foreign ownership on the association between female director in audit committee is expected by this study. The result revealed positive insignificant contrary with the prediction of this study. It means that appointment of female director into audit committee in companies with high foreign ownership has no impact on earnings management. Prior to the interaction, the result between female director in audit committee and earnings management was positive and significant meaning females appointment lead to higher earnings management. From another perspective, it can be argued that there is an improvement after the interaction of foreign ownership because the result now showed that females in audit committee has no impact, which is better than arguing that they lead to higher management. In this respect, foreign ownership is said to succeed after the interaction.

In addition, this study expects significant moderating effect of foreign ownership on the association between audit committee meeting and earnings management. The result (after interaction of foreign ownership) is negative and significant in accordance with the prediction of this study. It validates the assumption that foreign owners in a company ensure that audit committee is active. The more the committee is active the more its effectiveness and ability to control the management that could lead to lower earnings management. Prior to the interaction of foreign ownership, the association between audit committee meeting and earnings management was positive insignificant. However, after the interaction the association is negative significant. Therefore, foreign ownership moderates the association between audit committee meeting and earnings management.

The moderating effect of foreign ownership on the association between audit committee overlapping and earnings management is positive and significant as hypothesizes by this study. Prior to the interaction, the significance level was 10% but changed to 5% (making the relationship stronger). This showed that overlapping over-stretched audit committee members and reduces their monitoring capacity. This negates the argument that overlapping benefits through experience gained from other committee.

Additionally, the moderating effect of foreign ownership on the association between external auditors' type and earnings management is negative and significant at 1%, which support the prediction of this study. Prior to the interaction of foreign ownership, the association between external auditors' type and discretionary was negative at 5%. The result indicates that with the presence of foreign ownership, the Big 4 external auditors are effective in providing qualitative audit that can lessen agency cost.

Finally, the study assumes significant moderating effects of foreign ownership on the association between external auditors' independence and earnings management. The study found insignificant negative association after the interaction of foreign ownership. This means that foreign ownership does not moderate the association between external auditors' independence and earnings management. The result on the association between external auditors' independence and earnings management prior to moderation was positive and significant prior to the interaction of foreign ownership indicating that long audit tenure reduced external auditors' independence. Table 5.1 shows the summary.

Table 5.1

Tested Hypotheses Summary of Results

	Hypotheses	Sign	Results	Assessment
H1	*There is a significant association between audit committee size (ACSIZE) and earnings management (EM) in Nigeria.*	±	Negative significant	supported
H2	*There is significant negative association between audit committee independence (ACIND) and earnings management (EM) in Nigeria*	-	Negative significant	Supported
H3	*There is significant negative association between audit committee independence (ACEXPERT) and earnings management (EM) in Nigeria*	-	Dropped	Dropped
H4	*There is a significant association between the female director in audit committee (FEMDIRECT) and earnings management (EM) in Nigeria.*	±	Positive significant	Not Supported
H5	*There is a significant association between audit committee meeting (ACMEET) and earnings management (EM) in Nigeria*	±	Positive insignificant	Not Supported
H6	*There is a significant association between audit committee overlapping (ACOL) and earnings management (EM) in Nigeria*	±	Positive significant	Supported
H7	*There is a significant association between auditors' type (EAT) and earnings management (EM) in Nigeria*	±	Negative significant	Supported
H8	*There is a significant positive association between auditors' independence (EAIND) and earnings management (EM) in Nigeria.*	+	Positive significant	Supported
H9	*Foreign ownership (FO) significantly moderates the association between audit committee size and earnings management in Nigeria*	±	Negative significant	Supported
H10	*Foreign ownership (FO) significantly moderates the association between audit committee independence and earnings management in Nigeria*	-	Negative significant	Supported
H11	*Foreign ownership (FO) significantly moderates the association between audit committee expertise and earnings management in Nigeria*	-	Dropped	Dropped
H12	*Foreign ownership (FO) significantly moderates the association between female director and earnings management in Nigeria*	±	positive not significant	Not Supported
H13	*Foreign ownership (FO) significantly moderates the association between audit committee meeting and earnings management in Nigeria*	±	Negative significant	Supported
H14	*Foreign ownership (FO) significantly moderates the association between audit committee overlapping and earnings management in Nigeria*	±	Positive significant	Supported
H15	*Foreign ownership (FO) significantly moderates the association between external auditors' type and earnings management in Nigeria*	±	Negative significant	Supported
H16	*Foreign ownership (FO) significantly moderates the association between external auditors' independence and earnings management in Nigeria*	+	Negative insignificant	Not Supported

5.4 Implications of the Study and Recommendations

This study extends the literature on the agency theory and *RDT* and as regards to the audit committee characteristics (audit committee size, audit committee independence, audit committee expertise, female director in audit committee, audit committee meeting and audit committee overlapping). Other variables are external audit characteristics (external auditors' type and external auditors' independence). Furthermore, the study introduced and tested the moderating effect of foreign ownership on the association between audit committee and external audit characteristics and earnings management. The study has theoretical and managerial implications:

5.4.1 Theoretical Implications

Agency theory and *RDT* have been extensively applied in studying the impact of audit committee and external audit characteristics in mitigating earnings management (Abdul Rahman & Ali, 2006; Du, Ronen & Ye, 2015; Garven & Taylor, 2015; Ioualalen, 2015; Karamanou & Vafeas, 2005; Klein, 2002; Mustapa et al., 2014; Saleh *et al*., 2007; Wan Mohammed *et al*., 2016). Agency theory focuses on separation of ownership, control and monitoring and RDT emphasized expertise and experience. These theories emanated from the developed economies with relatively strong corporate governance culture. Despite that, the theories are still applicable in developing countries like Nigeria. For example, the main agency problem in Nigeria is between controlling and minority shareholders (Sanda *et al*., 2011). Controlling shareholders were found to have engaged in income-increasing earnings management for selfish interest, which led to collapse of the company such as Oceanic

Bank and Intercontinental Bank cases (Sanusi, 2010). The firm-level mechanisms need to be strengthened to lessen the agency problem (Sanda *et al*., 2011). In addition, previous studies on corporate governance in Nigeria and other African countries, applied agency theory due to its relevance (for example, Osazuwa, Che-Ahmad, & Che-Adam, 2016; Osemeke & Adegbite, 2016; Waweru & Riro, 2013).

Similarly, RDT is relevant and applicable in Nigeria because companies strive to appoint people with cognate experience into board or audit committees. Specifically, the revised code of corporate governance (2011) in relation to board provides that board members (from whom audit committee members are drawn) shall possess relevant core competences and entrepreneurial spirit. They should also have a record of achievement and should be knowledgeable. Audit committee should also have a financial literate director in its composition. Therefore, issue of expertise and experience, which is the focus of RDT is very much relevant in Nigeria. RDT was applied in the study of corporate governance in Nigeria and other African countries (for example, Abeysekera, 2010; Ujunwa, 2012; Odewale, 2016; Ujunwa, Okoyeuzu, & Nwakoby, 2012).

Additionally, this study employs RDT to study the association between female director in audit committee and earnings management. RDT is of the view that female directors can bring additional expertise and experience into the work of audit committee to effectively monitor management. In Nigeria, the civil societies and women group continue to agitate for 35% affirmative action. When this becomes a law, 35% positions in government and possibly corporate bodies would be reserved for women.

However, due to the mixed results and inconclusive outcomes of the previous studies, some studies introduced moderator in order to strengthen the association between the audit committee characteristics and earnings management. For example, Miko (2016) used institutional ownership as moderator between few audit committee characteristics and earnings management. In a similar study, Al-Rassas and Kamardin (2016) used audit committee independence and audit committee expertise as moderator between internal audit function and earnings quality. Accordingly, this study extends the literature by introducing foreign ownership for the first time as a moderator to moderate the association between audit committee and external audit characteristics and earnings management. The introduction of foreign ownership as a moderator makes the associations between some audit committee and external audit characteristics stronger. For example, the respective association between ACSIZE, ACIND and ACOL with discretionary accruals was significant at 10% prior to interaction. The level of significance increased to 5% respectively after the interaction. EAT was significant at 5% prior to interaction, but increased to 1% after interaction. Equally, ACMEET became negative significant after interaction from positive insignificant before the interaction.

Even the association between female director in audit committee changed from positive significant prior to interaction, to negative insignificant after the interaction. The later result (model 2 after interaction) that female director in audit committee has no impact on earnings management could be a better interpretation than to argue that female director in audit committee increased earnings management (model 1). We can therefore argue that foreign ownership appears to succeed to a certain extent in model 2.

Another contribution of this study is by extending the literature on audit committee characteristics by considering two additional variables of audit committee overlapping and female director in audit committee. Mendez *et al*. (2015) confirm dearth of studies especially on audit committee overlapping, as most previous studies were specific on directors' interlocking. This study established that overlapping members might face time constrain and could not contribute much on their monitoring role.

5.4.2 Managerial and Policy Implications

This study established that audit committee and external audit characteristics are capable in mitigating earnings management especially when foreign ownership is involved. The study has practical benefit to government of Nigeria, regulators (for example SEC and FRCN), shareholders, prospective investors, foreign investors, professional bodies (for example, ICAN), stockbrokers, tax authorities (FIRS) and researchers.

The government will find the study useful and motivate it to encourage foreign ownership through policy formulation. With strong corporate governance, foreign investors may be attracted to invest in form of FDI or in companies already in existence. The expectation is that they will bring foreign capital such as investment fund, entrepreneurship, technical skills and technology to boost Nigerian economy. FDI escalates the speed of technological advancement in the host country because of the contagion effect of the advanced management practice and technology used by foreign companies (Findlay, 1978). Nigerian government can boost foreign ownership and FDI through fiscal incentives such as "tax sparing". It could be in form of lengthy tax holidays or tax reduction (Hines, 2000). He further argued that tax incentives are very effective in attracting foreign investment. In addition, Nigerian government can encourage foreign investors through flexible policy on profit repatriation. Although, it is important for foreign investors to reinvest part of their profit in Nigeria for future growth, measures to ease profit repatriation to a certain extent can encourage them to invest.

For regulators such as SEC, the findings of the study will help them understand modern techniques of earnings management and possible ways to reduce it through effective audit committee. SEC should consider inserting the issue of foreign ownership in the code of corporate governance in future revision. At present, both codes of corporate governance 2003 and 2011 were silent on foreign ownership. In addition, SEC should also consider an enforcement mechanism to make the code of corporate governance more effective especially compliance with the provisions on audit committee. The review of the corporate governance framework reveals that some companies flout the provision of the code on number of meetings and size of the audit committee and get away with it due to weak enforcement. The penalties for noncompliance should be strict the way it applies to financial institutions such as banks. Based on the review of the regulatory framework, it is observed that Nigeria has multiplicity of corporate governance codes, which occasionally create confusion and disharmony among the regulatory agencies such as SEC, FRCN and NSE. There is a need to review the relevant legislation to clarify roles and powers of every agency.

Similarly, tax authorities such as FIRS will benefit from the findings of this study because some firms manipulate earnings downward to reduce their tax liability or to reduce political risk. Similarly, professional bodies such as ICAN will find the study useful being external auditors. They need to understand their role in ensuring quality and reliable audit in order to reduce earnings management. The auditors also need to be independent of the management of the company they are auditing. This study establishes that external auditors' type and to a certain extent external auditors' independence affect level of discretionary accruals. Furthermore, the shareholders will find the results of this research useful. The shareholders should equally insist on audit committee attendance in addition to frequency of audit committee meeting. They should also advocate the engagement of quality external auditors that can check the excesses of managers. This is because in the event of corporate failure shareholders are the ultimate losers being owners of the company. The shareholders based on the findings of this study need not to promote gender diversity on board or in audit committee but insist on quality of the members. Likewise, prospective investors need to scrutinize the financial reports of firms prior to investment, this increase their need to understand how managers manage earnings.

Finally, other external users of financial reports of companies such as banks, insurance and financial institutions may benefit from the research. Companies that apply for bank loans may manage earnings upward to secure the loan. The banks need to understand various ways of which managers manipulate earnings and the importance of audit committee. The banks also need to understand that companies that have strong audit committee, reliable external auditors usually the Big 4 with foreign ownership have lower earnings management based on the results of this study.

5.5 Limitation of the Study

This study is not without some limitations. Firstly, there are other internal corporate governance mechanisms that can mitigate earnings management but this study is restricted to only audit committee and external audit characteristics. Secondly, many models exist that can measure earnings management but this study is limited to cross-sectional modified Jones (1995). Nevertheless, an extended modified Jones model by Yoon *et al*. (2006) was used in the robustness test. Thirdly, this study only coveres 93 companies out of the 143 listed companies under the nonfinancial firms on the NSE. This is due to unavailability of data because of late filling of returns. Fourthly, foreign ownership could be measured as proportion of foreign investors in audit committee. However, this study measured foreign ownership as a proportion of shares held by foreign investors in companies based on the sample data. Financial reports of public companies in Nigeria do not provide details about the country of origin of audit committee members. Therefore, measuring foreign ownership as the proportion of foreign investors that sit in audit committee may not be possible.

These limitations notwithstanding, this study is useful and a good determination to examine the moderating effect of foreign ownership on the association between audit committee and external audit characteristics and earnings management.

5.6 Recommendations for Future Research

The emphasis of this study is on the moderating effect of foreign ownership on audit committee and external audit characteristics and earnings management. This study recommends future studies to consider other type of ownership such as family ownership, public sector ownership, cooperative ownership, minority ownership, managerial ownership or institutional ownership as moderator. Secondly, this study recommends future studies on the impact of women in audit committee possibly by gathering additional data. Already data for 50 companies for six years (300 firm-year observations) under the non-financial sector are not covered by this research. With that data available, the impact of female director in audit committee could have change to negative and significant. Finally, considering the criticism of accrual methods as a measure of earnings management, this study recommends use of other methods such as assets-turnover/profit-margin introduced by Jansen, Ramnath and Yohn (2012) and other models in future research.

5.7 Conclusion

This study examines the moderating effect of foreign ownership on the association between audit committee and external audit characteristics and earnings management applying agency and *RDT*. The study tested fourteen hypotheses on the direct and moderating effect of foreign ownership on audit committee and external audit characteristics in reducing earnings management. Out of the fourteen hypotheses tested, ten confirmed what the study predicts and the remaining four do not support.

The study establishes that audit committee size, audit committee independence and external auditors' type could mitigate earnings management because they are negative and significantly related to earnings management before and after moderation. Audit committee overlapping could increase earnings management because it is positive and significantly affects earnings management before and after moderation of foreign ownership. The female director in audit committee is positive and significantly affects earnings management before moderation. The audit committee meeting could reduce earnings management only after moderation because it is negative and significantly related to earnings management. External auditors' independence is positive and significantly affects earnings management only before the moderation.

The conclusion of this study is that audit committee and external audit characteristics mitigate earnings management mostly in companies that have foreign ownership in Nigeria. The study established that after the moderation of foreign ownership, all the audit committee and external audit characteristics with the exception of female director in audit committee and external auditors' independence mitigate earnings management.

Additionally, based on the result of the paired-sample t-test, the level of earnings management reduced after the revision of corporate governance code in 2011. However, the reduction cannot be attributed entirely with certainty to the audit committee. Nevertheless, Okike and Adegbite (2011) attributed the general improvement in corporate governance in Nigeria to increase in foreign investment because foreign investors strive to ensure that their investment is safe. Accordingly, this study recommends enforcement to ensure strict compliance with the provisions of the code of corporate governance especially that of the audit committee to avoid violation by public companies. Stricter compliance with the provision of the corporate governance code increase confidence of investors' especially foreign investors. Stringent sanction for noncompliance with corporate governance provisions attracts foreign investment (Bhatta *et al*., 2016).

Secondly, this study also recommends to policy makers to enact laws that would further encourage foreign ownership in public companies because their presence not only strengthen audit committee and mitigate earnings management but also attract more FDI into the country and bring along myriad of benefits such as employment. SEC should make effort to increase foreign ownership in public firms by recommending it in future corporate governance code revisions.

This study recommends further research on the impact of female director in audit committee. Inclusion of more women on board or in audit committee may increase their contribution. Based on the sample data of this study, few women sit in audit committee. That may be the reason for the unfavorable result obtained that women could increase earnings management. Further research on external auditors' independence in mitigating earnings management is also recommended. Specifically, the study recommends a different measurement of external auditors' independence such as NAS if data is available. Finally, the study recommends future research to focus on other forms of measuring earnings measurement different from accrual model.

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