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



**DOCTOR OF PHILOSOPHY  
UNIVERSITI UTARA MALAYSIA  
JULY 2017**

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



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**Thesis Submitted to  
Tunku Puteri Intan Safinaz School of Accountancy,  
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In Fulfillment of the Requirement for the Degree of Doctor of Philosophy**



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COMMITTEE CHARACTERISTICS AND EARNINGS MANAGEMENT IN  
NIGERIA**

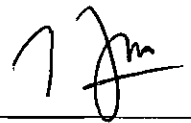
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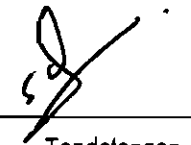
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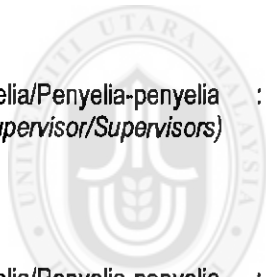
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## ABSTRACT

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 ketahanan 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 akurasi 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 bertindak 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 berkaitan 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



## ACKNOWLEDGEMENT

I am grateful to the almighty Allah for giving me life, health, courage and resources to pursue and complete this lonely journey. May the blessing of Allah continue to be with his messenger (Prophet Muhammad S.A.W), his household, his companions and those who follow their step until the day of Judgment.

I am particularly grateful to my supervisors; Associate Professor Dr. Hasnah Kamardin and Dr. Siti Seri Delima Abdul Malak for their professional guidance that made this study a reality. I cannot express the level of support given to me by these great scholars despite the fact that sometimes I stay far away, from where they are. I pray to Allah to give them and their families' good health, long life and reward them with Jannatul-firdaus.

At proposal and viva levels, I am grateful to Professor. Dr. Mohammed Ali, Associate Professor Dr. Rohaida Abdul Latif and Professor Dr. Nazli Anum bt Mohd Ghazali for their meaningful recommendations that helped in shaping this thesis.

I would like to use this opportunity to pray for my late parents; Alhaji Musa Muhammad and Hajara Abubakar. May their souls rest in Jannatul-firdaus. I appreciate my wife Fatima for her support, prayer and patience during this journey. I also appreciate my children; Hajara, Muhammad, Ahmad and Zahra. May Allah bless them.

My special appreciation goes to people like Professor Kabiru Isa Dandago who inspired me to pursue the PhD. Similar appreciation goes to Dr. Muktar Shehu Aliyu, Dr. Nuraddeen Usman Miko and Dr. Yusuf Ibrahim Kofar Mata and many others who supported me technically during this research.

It is my hope that this great task would benefit humanity in general.

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## LIST OF ABBREVIATIONS

AEM	Accrual-based Earnings Management
ACSIZE	Audit Committee Size
ACIND	Audit Committee Independence
ACEPERT	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

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