AUDIT COMMITTEE DIVERSITY AND EARNING MANAGEMENT AMONG LISTED MANUFACTURING FIRMS IN NIGERIA

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Abstract
Recently, numerous financial scandals have shown that many companies produce manipulated financial information. Consequently, regulators have prescribed corporate governance structures to protect investors and to reduce manipulation of earnings by management but there is increase in cases of earning management among listed manufacturing firms in Nigeria. Hence this study tends to specifically ascertain the effect of audit committees' financial expertise and audit committees' frequency of meetings on earnings management. This study adopted ex post facto design and generated data from secondary sources. Purposive sampling technique was used to select thirty – one sample size from fifty-eight listed manufacturing firms on the Nigerian Exchange Group as at 31st December, 2022. The study covered the period of 2011 to 2022. The study found that audit committee member financial expertise and audit committee frequency of meetings does not have any significant effect on real earnings management. The study recommends among others that Since numbers of meeting held by audit committee within company accounting year do not leads to minimizing or reducing real earnings manipulation, the committee should be guided by regulatory authorities (Financial reporting council of Nigeria, Nigeria Exchange Group among to others) to be serious minded during their meetings. The audit committee members should not see their position on corporate governance structure as ceremonial position without adhering to law that created the committee.
Keywords: *Earnings, audit committee, financial expertise.*

Introduction

Management uses different types of accounting techniques to prepare their earnings in order to achieve their predetermined objective. Healy and Wahlen (2019) said earnings management involves manipulating earnings figures, being disclosed, by the use of the judgmental discretions as allowed by the generally accepted accounting principles (GAAP), to suit management goals and deceived financial reports users to believe earnings figures that is not true. This act makes management to enjoy favourable response from company stakeholders about their financial performance which depend on earnings reported in financial statement.

However, Jara and Lopez (2011) described earnings management as a technique employed by management to modify company's earnings so that the accounting figures will reflect management set objective. Scott (2007) view earnings management as a choice of accounting policies made by management from generally acceptable accounting principles to maximize company market value. Therefore, intentional manipulation of the results is referred to by academic literature as earnings management.

It was observed by Subair, Salman, Abolarin, Abdullahi, & Othman, (2020) that management engaged in earnings management by influencing stock prices, debt structuring, fulfilling analysis expectations among others. Earnings management is primarily done through real earnings and discretionary accruals. Management deliberate intention towards manipulating real value of firm assets, financial positions, account receivable and other transactions affects stakeholders in making an informed investment decision. This make it necessary for government, as a stakeholder, to take steps in controlling management from manipulating earnings and this leads to strengthen corporate governance structure.

In corporate governance, disclosure and transparency are crucial in building trust and confidence among investors, creditors, and other stakeholders. Adeniyi (2020) observed that disclosure takes place when a company provides financial information and details of its operations to stakeholders, while transparency occurs when this information is open and accessible to stakeholders. Publicly listed companies must disclose financial performance, board composition, executive compensation, and related-party transactions. Many countries have made efforts to address this situation so as to guarantee the credibility of the financial statements by ensuring strong corporate mechanisms and strict compliance with accounting standards.

The government has taken steps to improve corporate governance with the enactment of the Companies and Allied Matter Acts (CAMA), (2004) Section 359 (6a) empowered audit committee to ascertain whether the accounting and reporting policies of the company are in accordance with **legal requirements** and *agreed* **ethical practices. Moreover,** CAMA, 2020 includes provisions for establishing a Corporate Affairs Commission ("CAC") to regulate the activities of companies in Nigeria, provisions for protecting minority shareholders, and the disclosure of information to stakeholders. The audit committee is a subcommittee of the Board that specializes in ensuring the accuracy and reliability of financial statements submitted by management (Habbash, Sindezingue, & Salama, 2013).

Recently, numerous financial scandals (WorldCom, Nortel, eToys, Afribank Plc, Oceanic Bank Plc, Cadbury Nigeria PLC, among others) have shown that many companies produce manipulated financial information. Consequently, regulators have prescribed corporate governance structures to protect investors and to avoid fraudulent financial reporting which are likely to control managers and limit their opportunistic behaviour and then to improve reporting quality. Thus, there has been much debate over the extent to which corporate governance structure encourage financial reporting quality from the theoretical perspective of agency theory (Bedard & Gendron, 2010; Li, Mangena, & Pike, 2012).

These problems are seen to be more significant in emerging markets like Nigeria where many market imperfections are persistent. This is particularly the case in Nigeria where cases of manipulations of reports to suit management interest still persist despite all government efforts which is seen in issuance of corporate governance code in years 2003, 2011, 2015 and 2018 respectively. Hence this study tends to specifically ascertain the effect of audit committees' financial expertise and audit committees' frequency of meetings on earnings management .

This study will be guided by null hypotheses that state that; audit committees' financial expertise and audit committees' frequency of meetings does not have significant effect on earnings management. The study covers listed manufacturing firms in Nigeria for the period of 2011 to 2022.

Review of empirical literature

Kaoje, Alkali, and, Modibbo, (2023) studied the relationship between audit committee independence. audit committee size, audit committee financial expertise and earning management among listed food and beverages firms in Nigeria. The study covered the period of 2014 to 2019. Data extracted from secondary sources was analyzed by Generalized Least Square (GLS) estimator. The study found that there is significant relationship between audit committee independence. audit committee size and earning management. While there is insignificant relationship between audit committee financial expertise and earning management.

It is observed from the study that its main focus is on listed food and beverages firms in Nigeria while it was stated in methodology and abstract that the population of the study is 190 firms and sample population is 150. This shows that the sample size covers all listed firms and not only food and beverage firms. Hence, findings of this study cannot represent true position of relationship between audit committee independence. audit committee size, audit committee financial expertise and earning management among listed food and beverages firms in Nigeria.

Wan Mohammad, Wasiuzzaman, Morsali, and Zaini (2018) examined how audit committee characteristics affect financial statement restatement among listed firms in Malaysia. The study covered 350 companies for the period of 2008 to 2009. Data collected through secondary sources was analysed by regression analysis. The study discovered that audit committee independence and audit committee expertise are statistically significant to financial statement restatement.

Mwangi, (2018) specifically studied the effect of audit committee financial competence and audit committee meetings on quality of financial reporting in Kenya. Census sampling technique was used to determine sample population. Seventy-two companies were used as sample population. The study used regression analysis to analysed data derived from secondary source. The study observed that audit committee financial competence and audit committee meetings had statistical significant relationship with the quality of financial reporting.
Suprianto, Suwarno, Murtini, Rahmawati, and Sawitri, (2017) examine audit committee members accounting expert and earnings management among listed firms in Indonesia. The study used Moderated Regression Analysis to analysed data collected from sample population was purposively selected. The study found that

accounting expert of audit committee members has negative effect on earnings management. Badolato, Donelson, and Ege, (2013) found a positive significant relationship between audit committee members having financial expertise and earnings management.

Agwor, and Osinachi (2018) studied how audit committee expertise affects earnings management among listed food and beverages manufacturing firms in Nigeria. The study used fifteen companies as its sample population which was selected through purposive sampling technique. The study proxy earnings management with discretionary accruals. Ordinary Least Square regression was used to analased data collected for the study. The study found that audit committee expertise has potential to reduce earnings management practices among the sample population.

Bala, Amran, and Shaari,(2019) investigated the relationship between audit committee financial accounting expertise, audit committee legal expertise and cosmetic accounting among listed companies in Nigeria for the period of 2008 to 2016. The study discovered a significant negative relationship between audit committee financial accounting expertise, audit committee legal expertise and cosmetic accounting. Inaam, and Khamoussi (2016) also found negative significant relationship between audit committee meetings and earnings management among sample population.

Orjinta, Onuora and Agubata (2018) examined the effect of audit committee independence, audit committee financial expertise on earnings management of quoted non- financial firms in Kenya, Nigeria and South Africa. The study measured earning management with classification shifting that is management discretion to manipulate items on income statement. The study used ex-post facto design with cross sectional data for the period of 2008 to 2017. Ordinary least square regression was used to analyzed data generated from secondary sources. The study found that audit committee independence and audit committee financial expertise has negative and significant effect on classification shifting. The study did not clarified technique used to get seventy-five firms as its sample population among many non-financial companies in Kenya, Nigeria and South Africa. Moreover, there is no justification for selecting Kenya, Nigeria and South Africa among Sub-Sahara Africa.

Handayan and Ibrani (2020) investigated the effect of audit committee characteristics on earning management among listed manufacturing firms in Indonesia. The study focused on audit committee that has expertise in industry and accounting, has expertise in industry and financial supervisors, the number of meetings of the audit committee members and earnings management. The study used quantitative method and covered the period of 2016 to 2018. The study found that audit committee members' expertise in industry and accounting does not have any significant effect on earnings management. Moreover, number of meetings of the audit committee members has no effect on earnings management. The population of the study and sample size was not stated in the study.

Design and Method

This study adopted ex post facto research design to ascertain how audit committees' financial expertise and audit committees' frequency of meetings affects real earnings management among listed selected manufacturing firms in Nigeria. This design will enable researcher to used data that is already available in public domain and cannot be manipulated by the researcher for the purpose this study.

The population of the study consist of listed manufacturing firms on the Nigerian Exchange Group. As at 31st December,2022, fifty-eight manufacturing firms were listed on the Nigerian Exchange Group floor. Purposive sampling technique was used to select sample population for this study. This technique was used to allow researchers to conveniently assess companies that data is available either on their corporate website or with Nigeria Exchange Group. thirty-one (31) manufacturing firms across the sector were selected as sample population for this study.
Measurement of variables

Earning management was measured by real earnings management. Real earnings management was measured by real activities manipulation: increasing incomes by reducing the overproduction costs for inventory (abnormal production costs) and decreasing discretionary expenditures including R&D, sales, advertising, and total and administrative expenditures (abnormal discretionary expenses.

Following Roychowdhury (2006), this study will estimate the normal level of production costs as follows:

$$PROD\ it/Assets\ it\text{-}1 = \alpha 0 + \alpha 1\ [1/Assets\ it\text{-}1] + \beta\ 1\ [Sales\ it/Assets\ it\text{-}1] + \beta\ 2\ [\Delta sales\ it/Assets\ it\ \text{-}1] + \beta 3\ [\Delta sales\ it\text{-}1/ Asset\ it\text{-}1] + \varepsilon\ it \qquad \text{Equ}\quad 1$$

Where:
PROD is the sum of the cost of goods sold in year t and the change in inventory from year $t-1$ to year t;
Assets$_{it-1}$ is the total assets in year $t-1$;
Sales$_{it}$ is the net sales in year t; and
Δ sales$_{it}$ is the change in net sales from year $t-1$ to year t.
This study developed the following regression model and employed the model to fulfill the research objectives:

$$REM = \beta 0 + \beta 1\ CAGEit + \beta 2\ CSIZEit + \beta 3\ CLEVit + \beta 4\ CPRFit + \beta 5\ COWSit + e it \qquad \text{equ } 2$$

Financial expertise of audit committee measured by *ratio* scale based on total number of accounting qualification, finance industry experience or audit committee who is a membership of professional associations to the total of audit committee members.

Audit Committee Frequency Meeting is the number of meeting held per year
Model specification

In specifying the model for this study, the researcher adapted and modified the model used by Raweh, Kamardin and Malik (2019); Olaoye, Olaoye and Adebayo (2019); Hope and Ikueze (2018). In a functional form, we have REM = f (EPS, CDPS, ROA) i
The model is adapted as REM = f (FEAC, ACFM) ii
Expressing equation in econometric form, we have
REM = β0 + β1FEACit +β2ACFMit + *e*it iii
The explicit regression model for the study are:
REMit = α + β0 + β1 FEACit + *e*it iv
REMit = α + β0 + β1 ACFMit + *e*it v

Where:
REM = real earnings management (Abnormal Production Costs)
FEAC= Financial expertise of audit committee
ACFM = Audit Committee Frequency Meeting
i = firm;
t = year;
β0 = the intercept;
e = the error term;
β1, β2, β3, β4… = the coefficients;

Data Analysis and Result

Hypothesis One

Ho: Audit committee member financial expertise does not have any significant effect on real earnings management among listed manufacturing firms in Nigeria

Hi: Audit committee member financial expertise have significant effect on real earnings management among listed manufacturing firms in Nigeria.

Table 1: Summary of the regression analysis of audit committee member financial expertise and real earnings management among listed manufacturing firms in Nigeria.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.032[a]	.011	-.002	.81744	1.806

Source: Researcher, 2023

Table 2: Analysis of variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.256	1	.256	.384	.536[b]
	Residual	247.238	370	.668		

	Total	247.494	371			

a. Dependent Variable: real earnings management
b. Predictors: (Constant), Financial expertise of audit committee
Source: Researcher, 2023

Table 1 and table 2 below shows the influence of audit committee member financial expertise on real earnings management among listed manufacturing firms in Nigeria. The analysis shows that R^2 is 0.011 which implies that 01.1% of audit committee member financial expertise variation experienced in real earnings management. The *f*-ratio (0.38) reveals that audit committee member financial expertise is not too important in reducing manipulation of real earnings by management of the selected manufacturing firms. Audit committee member financial expertise is not statistically significant because its significant value is 0.53 which shows that *P*> 0.05.

Therefore, alternative hypothesis (Hi) is rejected, while the null hypothesis (Ho) is accepted; this means that audit committee member financial expertise does not have any significant effect on real earnings management among listed manufacturing firms in Nigeria.

Hypothesis Two

Ho: Audit committee frequency of meetings does not have any significant effect on real earnings management among listed manufacturing firms in Nigeria

Hi: Audit committee frequency of meetings have significant effect on real earnings management among listed selected manufacturing firms in Nigeria

Table 3: Summary of the regression analysis of audit committee frequency of meetings and real earnings management among listed manufacturing firms in Nigeria**.**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.091[a]	.018	.006	.81445	1.816

Source: Researcher, 2023

Table 4: Analysis of variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2.064	1	2.064	3.112	.079[b]
	Residual	245.430	370	.663		
	Total	247.494	371			

a. Dependent Variable: real earnings management
b. Predictors: (Constant), Audit Committee Frequency Meeting
Source: Researcher, 2023

Table 3 and table 4 below shows the influence of audit committee frequency of

meetings on real earnings management among listed manufacturing firms in Nigeria. The analysis shows that R^2 is 0.018 which implies that 01.8% of audit committee frequency of meetings variation experienced in real earnings management. The *f*-ratio (3.11) reveals that audit committee frequency of meetings is not important in reducing manipulation of real earnings by management of the selected manufacturing firms. Audit committee frequency of meetings is not statistically significant because its significant value is 0.07 which shows that $P > 0.05$.
Therefore, alternative hypothesis (Hi) is rejected, while the null hypothesis (Ho) is accepted; this means that audit committee frequency of meetings does not have any significant effect on real earnings management among listed manufacturing firms in Nigeria.

Discussion of findings

The finding on hypothesis one shows that audit committee member financial expertise does not have any significant effect on real earnings management among listed manufacturing firms in Nigeria. This study is consistence with Kaoje, Alkali, and, Modibbo (2023); Handayan and Ibrani (2020); Bala, Amran, and Shaari,(2019); Orjinta, Onuora and Agubata (2018) that found financial expertise of audit committee members does not leads to reduction in manipulation of real earnings that is rampant among management of listed manufacturing firms. The implication is that either audit committee members have degree in Accounting, Finance or belonging to Accounting professional bodies not necessarily leads to reducing real earnings manipulation by management. It shows that financial expertise of audit committee members is not properly put to use in performing their duties as stipulated in Companies and Allied Matter Acts (CAMA), (2004) Section 359 (6a).

The study also discovered that audit committee frequency of meetings does not have any significant effect on real earnings management among listed manufacturing firms in Nigeria. This study agreeing with Mwangi, (2018); Inaam, and Khamoussi (2016); Badolato, Donelson, and Ege, (2013) that found that audit committee frequency of meetings does not influence reduction in real earnings manipulation by company management. The implication of this finding is that the numbers of meeting held by audit committee within an accounting year does not translate to reduction in real earnings manipulation among management of listed manufacturing firms in Nigeria.

Conclusion and recommendations

In view of the findings of this study, either audit committee members have degree in Accounting, Finance or belonging to accounting professional bodies or not does not translate to reduction in real earnings manipulation among management of listed manufacturing firms in which they are serving as audit committee member. While numbers of meeting held by audit committee within company accounting year do not leads to minimizing or reducing real earnings manipulation.

Recommendations

Since audit committee members with degree in Accounting, Finance or belonging to accounting professional bodies or not do not have effect on real earnings management of the company in which they are serving as audit committee member, board members need not to consider members' professional expertise in constituting audit committee.

Since numbers of meeting held by audit committee within company accounting year do not leads to minimizing or reducing real earnings manipulation, the committee should be guided by regulatory authorities (Financial reporting council of Nigeria, Nigeria Exchange Group among to others) to be serious minded during their meetings. The audit committee members should not see their position on corporate governance structure as ceremonial position without adhering to law that created the committee.

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