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EFFECT OF EARNINGS MANAGEMENT ON THE VALUE RELEVANCE OF LISTED FIRMS FINANCIAL STATEMENT IN NIGERIA.

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ABSTRACT

This study analyzed the effect of Earnings management on the value relevance of listed firms financial statement in Nigeria. The study used ex post factor research design and the secondary data gathered were analyzed using regression analysis. In line with the stated objectives, the findings reviewed that Discretionary accruals has a significant effect on the earnings per share of listed firms while Non Discretionary accruals has no significant effect on the Earnings per share of listed firms. It is therefore recommended that Listed firms in Nigeria accruals should be reported accurately and timely in other to capture the actual cost incurred so as to reflect the true value of the firm and makes its financial statement value relevant and Laws should be made to compel firms to report certain accruals because if this accruals are left at the discretion of the firm then, it is certain that the financial report will not reflect the actual values which in turn makes it not value relevant.

***Key Words**:* Discretionary accruals, Non Discretionary accruals, Earnings per share.

INTRODUCTION

BACKGROUND TO THE STUDY

As stated in Sun and Rath (2008), the primary role of financial statements is to disclose a company's financial information to internal and external users in a timely and reliable manner. This was further reiterated by the International Accounting Standard Board [IASB] (2001) that the objective of a financial report is to provide information about the financial position, performance and change in financial position of an entity that is useful to a wide range of users in making economic decisions . Sun and Rath (2008) asserted that in a perfect market, there is no role for financial disclosures and thus no demand for accounting discretion.

Accounting information refers to information about operations, performance and condition of business and other organization expressed primarily in monetary terms. One of the most important accounting information sources is financial statement. Over the years the issue of earnings management has been examined extensively in the literature. Despite the increasing interest of researchers in examining earnings management activities, few studies have examined its effect on investor returns in Nigeria, mostly studies focus on corporate governance related issues studies such as, (Dabor and Adeyemi, 2009; Adenikinju and Ayorinde 2001). Okolie (2014) documents a major scandals in Nigeria related to poor audit quality and earnings manipulations: Cadbury Nigeria Plc and African Petroleum (AP) (Okolie and Agboma, 2008). Numerous studies support the use of reported earnings and book value of a firm as a basis for firm valuation (Ohlson, 1995) but the relationship between earnings management and value relevance has not been ascertained. As a contribution to the existing literature, this present study intends to examine the effect of earnings management on value-relevance using quoted, non-financial firms in Nigeria.

The main objective of the study is to evaluate the effect of earnings management on the value relevance of Nigerian companies but its specific objectives include to:

1. Determine the effect of discretionary accruals on earnings per share of listed firms in Nigeria.
2. Ascertain the effect of Non-discretionary accruals on earnings per share of listed Nigerian firms.

REVIEW OF RELATED LITERATURE

CONCEPTUAL FRAMEWORK

According to Omoye and Eriki (2014), earnings management is recognized as attempts by management to influence or manipulate reported earnings by using specific accounting methods or accelerating expense or revenue transactions, or using other methods designed to influence short-term earnings. Earnings management occurs when managers use judgment in financial reporting in structuring transactions to alter financial reports, to either mislead some stakeholders about the underlying economic performance of the company, or to influence contractual outcomes that depend on reported accounting information. As stated in Algharaballi (2013) these definitions represent two common views of company management. The first view holds that management needs to exercise judgment in business operations and financial reporting since GAAP clearly requires management to make wise estimates and judgments. The second view is known as that of opportunistic earnings management, i.e. managers base their judgments and decisions on whether they will result in personal private gain (Healy and Wahlen,1999).

According to Dechow and Skinner (2000), earnings management can be classified into three categories, namely: Fraudulent Accounting, Accruals Management, and Cash Flow Earnings Management (CFEM) which is more often referred to as Real Earnings Management (REM).Fraudulent Accounting involves accounting choices that violate GAAP; Accruals Management involves choices within-GAAP that try to obscure or mask true economic performance. Real Earnings Management occurs when managers undertake actions that involve changing a firm's underlying operations in an effort to boost current period earnings. Fraudulent accounting and accruals management are not accomplished by changing the underlying economic activities of the firm but through the choice of accounting methods used to represent those underlying activities (Dechow& Skinner, 2000). Two key attributes of accruals result in earnings management being the main mechanism by which earnings management is operationalzed in the literature, namely; Non-discretionary and Discretionary accruals. Non-discretionary accounting adjustments are required by accounting standards and statutes, while discretionary accruals represent voluntary adjustments.

The main sources of GAAP for quoted companies in Nigeria are: Statements of Accounting Standards (SAS) previously issued by the Nigerian Accounting Standards Board (NASB) now the Financial Reporting Council of Nigeria (FRCN) requiring the compliance with IFRSs and IASs issued by IASB; The Companies and Allied Matters Act (CAMA), 2004; and Several other sources.

THEORETICAL FRAMEWORK

From a theoretical viewpoint, it can be noted that the existence of earnings management and the assumption of perfect markets conflict. If the information markets were perfect, there would be no possibilities to benefit from earnings management activities and a rational manager would not engage in managing earnings (Watts and Zimmerman 1986). Implicitly, it is assumed that management has an information advantage over a company's stakeholders.

Therefore, this study is anchored on the signaling theory but other relevant theories to the study are discussed as well.

The signaling theory: Signaling refers to a situation where one party conveys information to another party. Scott (2003) define signal as an action taken by a high-type manager that would not be rational if that manager was low type. Scott (2003) suggest that earnings management may be used for signaling. More specifically, the authors argue that earnings management to reveal persistent earnings power can be interpreted as a signal since earnings reversal can make

The agency theory: As propounded by Jensen and Meckling (1976) they asserted that a typical feature of a modern corporation is *the separation of ownership and control*. This includes that the owner (the principal) engages the manager (the agent) to perform services on behalf of her and delegates decision making authority to the agent. This so called agency theory helps to analyze the relationship between the principal and the agent. It analyses contracts designed to motivate a rational agent to act on behalf of a principal when her interests could otherwise conflict with those of the principal (Scott 2003). The separation of ownership and control has been seen as the original reason behind corporate governance problems (Bergstregger and Phillipon 2006). Taking the same viewpoint, it can also be seen as enabling earnings management. As ownership is separated from control (management), it is possible for managers to manage earnings against owners' interest (Scott 2003).

It is very costly for a low-type manager to report higher earnings that can be maintained.

EMPIRICAL REVIEW

As noted earlier, studies have suggested that accounting information is either value relevant, not relevant, or is losing its value relevance. Supporting studies on the argument that accounting information could be deemed value relevant in the determination of stock prices include, but not limited to studies in China (DeAngelo 1986;Olayinka (2012) Nigeria; Isemila and Aferisimi (2012); Odia (2007) Nigeria).

The general consensus of these sets of studies is that earnings and book values were value-relevant to the prices of stocks. Contrary to this argument, empirical resolve also indicate that given certain circumstances (for instance, a deliberate move by firms towards the adoption of high-technology and service oriented economy), accounting information have either lost, or is experiencing a wane or decline in their value includes studies like that of Wang, Swift and Lobo (1993) and Wild (1992).

METHODOLOGY

This study adopts ex-post facto research design. Ex-post facto research design involves the ascertaining of the impact of past factors on the present happening or event. The descriptive statistics is used to summarize the collected data in a clear and understandable way using numerical approach. The ordinary least square regression (OLS) method is adopted in investigating the relationship between the dependent and independent variables. The study adopts the preliminary test for incidences of co linearity in the model are also necessary. To do this, the variance inflation factor (VIF) statistics and the tolerance level statistics were deployed to be used. The main advantage of these two statistics is that it filters out variables that might distort the result of regression analysis.

MODEL SPECIFICATION

The study formulates the following model to be used in testing the stated hypotheses:

$$\mathbf{EPS_{ft} = \alpha_0 + \alpha_1 DA_{it} + \alpha_2 NDA_{it} + t_{it}}$$

Total accruals= net income before extraordinary items less cash flow from operations/ Total assets

DA_{it}= Discretionary accruals of the firm at the time (total accruals less non discretionary accruals

NDA_{it}= Non-discretionary accruals of the firm at the time (Total accruals of the previous period/ total assets of the previous period)

EPS_{it}= earnings per share of the fir m at the time.

t_{it}= error term for firm i in year t

Decision Rule: Accept the null hypothesis, if the calculated value is greater than the significant level of 0.05 and vice versa.

DATA PRESENTATION AND ANALYSIS

Data Analysis

This section analyses the data presented in the previous section with the aid of statistical package for social sciences (SPSS, version 20.0). The analysis of data is presented in the subsequent sections:

Data Validity Test

In order to ensure that the results are robust, several diagnostic tests such as variance inflation factor (VIF) and Tolerance statistics were computed as shown in Table 4.3 below.

The Variance Inflation Factor (VIF) statistics for all the independent variables stood at 1.408. This indicates the absence of multicollinearity problems among the variables under investigation (Gujarati and Sangeetha 2007). In addition the tolerance values stood at 0.710 (see table 4.3). Menard (1995) suggests that a tolerance value of less than 0.1 almost certainly indicates a serious collinearity problem. In this study which is not the case in this study.

Descriptive Statistics

The descriptive statistics for both the dependent and independent variables are presented in table 4.1 below:

Descriptive Statistics

	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
DA	28	.00	1.01	.2214	.04763	.25204
NDA	28	.00	1.02	.2071	.04434	.23464
EPS	28	1.39	37.02	12.2568	1.94475	10.29065
Valid N (listwise)	28					

Table 4.1 presents the descriptive statistics of all the variables. N represents the number of paired observations and therefore the number of paired observation for the study is 28.

Discretionary accruals (DA) reflects a mean of 0.2214 and a standard deviation of 0.25204, it has a minimum value of 0.00 and a maximum value of 1.01. The Non Discretionary accruals (NDA) has a mean of 0.2071 with a deviation of 0.23464 also, with a minimum and maximum value of 0.00 and 1.02 respectively. The result also Earnings per share (EPS) has a minimum and maximum value of 1.39 and 37.02 respectively and reflects a mean of 12.2568 with a deviation of 10.29065

The result of the descriptive statistics in respect to the study's independent variables indicates that Listed agro firms consider the Discretional accruals more as a major variable of Earnings management that influence the value relevance of firms financial statement as a result of its high mean, the reason for this could be due to the fact that firms turn not to be manipulative with their report of such accruals since they are not compared by law to report such accrual which gives them the room to choose when and which to report and this becomes a basis where the financial statement earnings are adjusted to soothed their own reporting purpose.

Regression of the Estimated Model Summary

This section of the chapter presents the results produced by the model summaries for further analysis.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.375[a]	.141	.072	9.91292	.141	2.048	2	25	.150	.741

a. Predictors: (Constant), NDA, DA

b. Dependent Variable: EPS

Table 4.2, presents the regression result between DA, NDA and EPS. From the model summary table above, the following information can be distilled.

The R value of 0.375 shows that, there is a weak relationship between (DA, NDA) and EPS at 37.5%. Also the R^2 stood at 0.141.The R^2 otherwise known as the coefficient of determination shows the percentage of the total variation of the dependent variable (EPS) that can be explained by the independent or explanatory variables (DA and NDA). Thus the R^2 value of 0.141 indicates that 14.1% of the variation in the EPS of listed agro firms can be explained by a variation in the independent variables: (DA and NDA) while the remaining 85.9% (i.e. 100-R^2) could be accounted by other variables not included in this model.

The adjusted R^2 of 0.072 indicates that if the entire population is considered for this study, this result will deviate from it by only 0.069 (i.e. 0.141 – 0.072). This result shows that there is a deviation of the sample examined and the total population by 6.9%.

The table further shows the significant change of 0.150 with a variation of change at 14.1% indicate that the set of independent variables were as a whole contributing to the variance in the dependent.

Regression Results

Regression analysis is the main tool used for data analysis in this study. Regression analysis shows how one variable relates with another. The result of the regression is here by presented in this section.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	14.929	2.679		5.572	.000		
1	DA	-17.554	8.983	-.430	-1.954	.042	.710	1.408
	NDA	5.865	9.649	.134	.608	.549	.710	1.408

a. Dependent Variable: EPS

The regression result as presented in table 4.3 above to determine the relationship between DA, NDA and EPS shows that when the independent variables are held stationary; the EPS variable is estimated at 14.929. This simply implies that when all variables are held constant, there will be a significant increase in the EPS of listed firms up to the tune of 14.929 units occasioned by factors not incorporated in this study. Thus, a unit increase in DA will lead to a significant decrease in the EPS by 0.430. Similarly a unit increase in NDA will lead to a significant increase in EPS by 0.134.

Test of Research Hypotheses

The hypothesis formulated in chapter one will be tested in this section inline with the decision rule.

Ho_1: *Discretional Accruals has no significant effect on the Earnings per share of listed firms.*

Given that the significant level is 0.05 and the calculated value for Provision for Bad debt (0.042) is less than the accepted significant level, we therefore reject the Null hypothesis and accept the alternative.

Ho_2: *Non Discretional Accruals has no significant effect on the Earnings per share of listed firms*

Given that the calculated significance level for Salary and wages is 0.549 which is greater than the accepted significance level of 0.05, therefore the null hypothesis is accepted.

CONCLUSION AND RECOMMENDATION

Conclusions

The following conclusions are reached in respect to each hypothesis:

- Discretionary Accruals has a significant effect on earnings per share of firms.
- Non Discretionary Accruals has no significant effect on the earnings per share of listed firms.

Recommendations

In consonance with this study's findings, it is recommended that:

The firms accruals should be reported accurately and timely in other to capture the actual cost incurred so as to reflect the true value of the firm and makes its financial statement value relevant and Laws should be made to compel firms to report certain accruals because if this accruals are left at the discretion of the firm then, it is certain that the financial report will not reflect the actual values which in turn makes it not value relevant.

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