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Earnings Management and Financial Performance of Deposit Money Banks in Nigeria

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Abstract
The study was aimed at assessing the influence of accrual-based earning management on financial reports of deposit money banks in Nigeria. The research was motivated by the corporate collapse and failures experienced in the banking sector amidst the clean audit reports. The methodology adopted was ex-post facto. Using descriptive and inferential statistics, a sample of ten (10) deposit money banks (DMBs) were judgmentally selected for a period of eight (8) years, which resulted in eighty (80) data points. The data were obtained basically from published annual reports of accounts and accompanied notes to the financial statements. The results of Pearson Product-Moment Correlation and Linear multiple regression, revealed that discretionary accruals exerted significant negative relationship on the returns on asset of deposit money banks in Nigeria in pre (p = .004) and post (p = .005) International Financial Reporting Standards (IFRS) era. The results also showed that there existed relationships between accrual-based earnings management and financial performance of DMBs. Findings from the study revealed that earnings management existed in the DMBs. Based on the results; it was recommended that proper and adequate measures should be put in place for the evaluation, examination, and scrutiny of financial statements of DMBs.
Keywords: Earnings Management, Financial Performance, Return on Assets, International Financial Reporting Standards

1. Introduction

A financial report is an important tool for making economic decisions. The information presented in the financial statements is expected to be relevant, reliable and comparable to permit informed decisions by the users. The information in the financial statements guides the existing and potential investors to sustain or invest in the company. The only means which directors of companies related to the stakeholders is through published financial statements that state the financial performance, progress, and position of the business (Ijeoma, 2014). The stakeholders based the performance assessment of managers on the information provided in the financial statements. The statements are very useful because they signify the quality of management performance in a given period of time.

Earnings management may be applied to mislead the owners of the company or investors by conducting garnished accounting, because sometimes manipulation of accounting figures is safe and does not violate Generally Accepted Accounting Principles (Haryudanto & Yuyetta, 2011). Sequel to the important role of financial statements in demonstrating the performance of a company, management usually mislead investors or the owners of the company by distorting the true position of the financial statements using any methods of manipulation. Managers of organizations tend to use earnings management to manipulate accounting information presented in the financial statements thereby making it creative to attract and mislead stakeholders.

Earnings management can be categorized into two perspectives namely, accruals based-earnings management (AEM) and real earnings management (REM) (Roychowdhury, 2006). Accrual-based earnings management refers to manipulating earnings through the application of accounting principles provided by GAAP, whereas REM implies inflating earnings by changing some business transactions as well as managers indulging in actions that deviate from best practices to report higher earnings (Ewert & Wagenhofer, 2005; Roychowdhury, 2006). Activities that relate to AEM are allowances for receivables and timing asset write-offs whereas REM includes manipulation of research and development expenses, excess production, variations in sales and advertising expenses. The manipulative behavior by the managers of organizations have significant effects on various accounting performance measures such as return on asset, return on equity, return on capital employed and so on.

Past studies on earnings management and performance focused on other measures of earnings management such as operational risk and total accruals in the manufacturing sectors (Anichebe, 2009; Shehu & Abubakar, 2012; Saidi & Rubie, 2013). Other studies conducted in the banking sector used loan loss provision as a measure of earnings management (Abubakar, Abdu & Abdulmaroop, 2014). Most studies used discretionary accruals and return on capital employed (ROCE), return on asset (ROA), return on equity (ROE), earnings per share (EPS) as proxies for performance (Osazevbaru, 2012; Saidi & Rubie, 2013), but not in the banking sector. This study will concentrate on accruals-based earnings management and return on the asset as a measure of performance. This study, however, used discretionary accruals, adopting modified Jones Model as a measure of earnings

management and return on the asset as a proxy for performance. The study focuses on finding the effect of earnings management practices on the return on asset (ROA), before and after IFRS era as well as examining the relationship between accrual-based earnings management and return on assets of deposit money banks in Nigeria. The main objective of this study is to find out the relationship between earnings management and financial performance of deposit money banks in Nigeria. To this end, this paper is divided into five sections, after the introduction, various literature was reviewed in section two. Section three deals with methodology, while section four presents the results of the data analyses and findings. The summary, conclusion and recommendations are contained in the last section.

2. Review of Related Literature

Earnings management is becoming an area of concern to many researchers, after the case of Enron in the United State of America, and other similar accounting scandals in Nigeria particularly in deposit money banks such as the failure of Afrikbank Plc., Intercontinental Bank Plc, Bank PHB and Oceanic Bank Plc. The revelation of unethical practices by bank executives and board members of deposit money banks in Nigeria has raised many questions about the ethical standards of the accounting profession and the integrity of financial reports issued by professional accountants.

In recent years, earnings management practices have been on the increase in deposit money banks. Bank executives attract unsuspecting investors and obtain undeserved accounting-based rewards by presenting plausible misleading or deceptive state of bank financial affairs. The adoption of IFRS launched in September 2010 by the Honourable Minister, Federal Ministry of Commerce and Industry, Senator Jubril Martins-kuye (OFR) which was organized in stages. The adoption by Public Listed Entities and Significant Public Interest Entities was by January 2012 of which deposit money banks was inclusive and it was expected that all stakeholders should use the IFRS by January 2014. Nigerian companies adopted based on the specifications in the guidelines issued by the International Accounting Standards Board. The adoption of IFRS by deposit money banks in Nigeria as against the General accepted accounting principles (GAAP) applicable before IFRS adoption has brought significant improvements in the preparation and credibility of financial statements and disclosures (Ijeoma, 2014).

Earnings management is the deliberate manipulation of financial information to either mislead potential and existing investors on the underlying economic status of a firm or to gain some contractual incentives that depend largely on the fluctuations of accounting numbers (Watts & Zimmerman, 1999; Bergstresser & Philippon, 2006). Accruals are the most important earnings management instruments that are used by managers to fluctuate reported income. This is because they are “components of earnings that are not reflected in current cash flows and a major managerial discretion go into their construction” (Bergstresser & Philippon, 2006).

The rewards for earnings manipulation have been identified in the literature in vast contexts. Bhat (1996) identified this as an attempt to enhance shareholders’ value and to increase managers’ compensation through income smoothing and creative accounting respectively. Healy & Wahler (1999) observed that the outcome to “window dress financial statements” includes the zeal to increase managers’ compensation and sustain job security, to avoid the distortion of debt deeds, and to decrease regulatory costs or increase regulatory benefit. Income smoothing, occasional big bath, living for today and maximization of variability are identified by Healy & Wahler (1999).

Chang, Shen & Fang (2008) identified three incentives to manage earnings namely: consequent on capital market motivation, which includes initial public offerings, shares allotment, management extravagant estimates and firms’ synergy to meet earnings forecast; debt agreement or job security; laws and regulations such as import regulation, and industrial regulation. Cornett, McNutt & Tehranian (2008) asserted that managers use discretionary accruals as a motivation for options (the incentive for bonus income by attaining some level of performance) and affecting stock prices to enhance managers’ wealth through stringent stock compensation. Other incentives for managers’ opportunistic behavior that are established in the literature include bonus plans, meeting analyst’s expectations or raising funds on more favorable terms (Chang, Shen & Fang, 2008). Consequently, this may affect the long-term performance of the company’s response to shocks. In this case, accruals-based earnings management is expected to have a negative association with the financial performance of the company. Regarding this, the measurement of true financial performance is stripped of the influence of opportunistic earnings management practices by the management, which is expected to portray the true status of the company.

The Agency theory is a common practice in research that explains the relationship between the principal (shareholders) and the agent (managers). Separation of ownership and control leads to potential conflicts of interest between both parties. This may be because the parties may have different goals, and the managers may not act on behalf of the best interests of the shareholders (Jenson & Meckling, 1976). Gerayli, Yanesari & Ma’atoofi (2011) confirmed that this agency problem leads to the demand for external auditing. This study is based on the Agency theory. Agency theory has a direct relationship on information transmission to the principal.

The information variations from the agents to the principals brought about the involvement of a third party to mediate and affirmed the credibility and reliability of information related to the stakeholders.

Empirically, studies have been conducted on earnings management and financial performance of different sectors which are well documented in the literature. Ijeoma (2014), carried out a study to examine the effect of Earnings management in the Nigerian banking industry. The primary source of data collection was employed in the study and Kruskal-Wallis statistical tool and the multiple bar chart analysis was utilized. The result of this study revealed that the major reason for earnings management practices in the Nigerian banking industry was to inflate the operating costs, to reduce exposure to taxes and to maintain or boost the share price by reducing the apparent levels of borrowing, making the company appear subject to less risk and of a good profit trend. Hauwa, Ocheni & Jamila (2017) examined the impact of earnings management on the financial performance of listed deposit money banks in Nigeria. Data were extracted from the annual report and accounts of five sampled banks for the period 2011-2015. Loan loss provision was used as a proxy for earnings management while return on assets (ROA) was used as a proxy for banks performance. The study employed linear regression of pooled ordinary lease square for data analysis. Findings from the study revealed that earnings management exists in the Nigerian deposit money banks. However, the study could not establish any statistically significant impact of earnings management on ROA.

Abubakar, Abdu & Abdulmaroop (2014) empirically examined the impact of loan loss provision on earnings of deposit money banks in Nigeria using econometric analysis method on annual data of eight financial institutions over the period of 2006-2011. The results from the study stated a positive relationship between provision for loan loss and earnings management in Nigerian deposit money banks. Naila, Ahmad, Mian (2014) determined the impact of earnings manipulation in future financial performance. A generalized least square (GLS) method was used for data analysis. A sample of 119 firms listed in Karachi Stock Exchange (KSE) for the periods 2004–2011 was used. The study showed that firms engaged in real earnings management (REM) activities through sales manipulation to report higher earnings have worse financial performance in future. It reveals that earnings manipulation seems helpful and appealing in current situation but creates problems in future. Nabil & Hassan (2014) determined the impact of applying financial performance indicators on earnings management in manufacturing companies listed at Amman Stock Exchange. Descriptive and analytical approach was used to analyzed financial statements and reports from a sample of Jordanian manufacturing companies using statistical tools to test the research hypotheses. Data were gathered from a sample of 52 manufacturing companies based on a series period from 2007 – 2011. Findings showed that there is no impact of financial performance indicators (EPS and CR) on the process of earning management in the sample studied,

Saidi & Rubie (2013) examined the relationship between real earnings management activities and future performance of firms listed on Tehran Stock Exchange (TSE). A sample of 89 companies was purposively selected from the Stock Exchange between the periods 2004 to 2013.The study used Ordinary Least Square Regression; results from this study showed that there is a significant negative association between proxy for real earnings management and future performance. Ghorbani, Nazmy & Ardekani (2011) examined the impact of real earnings management on the future return on assets. A sample of 119 firms listed in the Karachi Stock Exchange for the years 2004 to 2011 using a panel data and generalized least square (GLS) technics. The results of the study revealed that there is a significant relationship between proxies for real earnings management and future return on assets. Gunny (2010) realized that firms tend to engage in earnings management using real activities manipulation. The results of this study showed that cutting the expenses of research and development and overproduction has a positive association with real activities manipulation. Also, the earnings resulted from the real activity earnings management are negatively associated with future performance of firms.

Taylor & Xu (2010) examined the negative relationship between real earning management and subsequent operating performance of the US companies. By taking sales manipulation as proxy of REM and ROA, ROE, EPS and PE ratio as measures of financial performance, the study revealed the followings - there existed a negative effect on ROA of the firms which manipulate earnings by sales manipulation; there was a negative influence on ROE of the firms which manipulate earnings by sales manipulation; there was an indication of negative effects on EPS of the firms which manipulate earnings by sales manipulation; and finally a negative relationship on PE ratio of the firms which manipulate earnings by sales manipulation. Mashayekhi, Mehrani, Mehrani & Karami (2005) investigated the role of discretionary accruals in earnings management of listed companies in Tehran Stock Exchange. The purpose of the study is to examine the reason managers pursue earnings manipulation. The results indicated implementation of earnings management in the surveyed companies. Furthermore, when the amount of operating cash is reduced (entity's fragile performance), the managers increase the earnings through discretionary accruals in order to compensate themselves.

Baharmoghaddam & Kuhi (2009) studied the type of earnings management for listed companies in Tehran Stock Exchange. The objective of the study was to examine the effectiveness or opportunism of earnings management. The relationship between earnings management and future profitability was assessed using five earnings management models, that is, Jones Model (1991), Jones Adjusted model (1995), Kaznic Model (1999),

and also modified models of Adjusted Jones and Kaznic models. The results revealed that earnings management in Tehran Stock Exchange has a negative tendency towards efficiency. Also, the results of comparing different models indicated that in the economic environment of Iran, first Adjusted Kaznic model and then Kaznic model show the highest predictive power of measuring earnings management. The capability of Jones model in a true classification of the components of accruals into normal and abnormal is questionable and therefore, the possibility of the wrong classification of accruals into discretionary and non-discretionary is quite probable.

Based on the above-mentioned literature, it can be expected that accrual-based earnings are negatively associated with performance of firms because managers tend to jeopardize the accruals in favour of current period income of their firms. Studies on earnings management and performance are mostly carried out on manufacturing sectors. Limited studies were carried out on earnings management and performance in the banking sector. However, this research will examine the relationship between earnings management and performance before and after IFRS adoption by deposit money banks in Nigeria. Thus, the research hypotheses are formulated as follows:

Ho_1 There is no significant relationship between accrual-based earnings management and return on assets before and after IFRS adoption by deposit money banks in Nigeria.

Ho_2 There is no significant relationship between accrual-based earnings management and return on assets of deposit money banks in Nigeria.

3. Methodology

The ex-post facto research design is adopted to examine the relationship between earnings management and financial performance of deposit money banks in Nigeria. The research design is appropriate because it allows for the determination of the relationship between earnings management and financial performance. The population of this study is the fifteen deposit money banks listed on the Nigerian Stock Exchange as of December 2015. Judgemental sampling techniques were adopted based on assets base and deposits to select the ten (10) deposit money banks from the population within the periods 2008 to 2015. The pooled data covers the period of eight years (2008-2015), resulting in 80 data points. Secondary data was used in this study, collected from the sampled deposit money banks' annual reports of relevant years.

Considering the nature of the data which is time series, the study, therefore, employs multiple regressions using pooled Ordinary Least Square (OLS) regression. A simple model was employed to determine the effects of earnings management on the performance of DMBs. The quality of earnings management could be estimated as a function of the firm's agency characteristics, which have been defined in this study as discretionary accruals. The specification of this model is based on Agency theory. This is expressed as: EM = f (DAC)

The panel data regressions that will be used to estimate the relationship are as follows:

$ROA=\alpha_0 + \alpha_1 DAC + \alpha_2 SIZE + \alpha_3 AGE + e$ as adopted from the work of James (2008), but was modified in this study because of the fact that the sector under consideration is deposit money banks which differ from the sector studied by James (2008).

Explicitly, the regression model is specified as:

$$LNROA = \beta_0 + \beta_1 LNDAC + \beta_2 LNbankSize + \beta_3 LNGwth + \beta_4 LNLev + Є$$

Where:

LNROA= natural log absolute value of return on total asset; which is calculated as net profit after tax less total assets by 100% (Dependent variable)

LNDAC = Natural log of absolute value of discretionary accruals based on the Modified Jones Model (Independent Variable)

LNBankSize = Natural log of bank size; Natural log of company Total Assets (Control Variable)

LNBank Growth = Natural log of Bank growth; Growth is measured as Market value divided by book value of equity (MPS/BVPS) (Control Variable)

LNLeverage = Natural log of Leverage; Leverage (LEVR) is measured as total debts divided by debt plus equity. Leverage will help to ensure that extraneous variables such as debt commitments and size or assets composition which are external to the purpose of this study are minimised, nullified or isolated. (Control Variable)

Є = Error Term

β_0 = intercepts

$\beta_1, \beta_2, \beta_3,$ - - β_4 = Coefficients of the independent variables

Consistent with Modified Jones Model, total accruals are defined as income before extraordinary items minus operating cash flows. OLS regression is used to obtain industry-specific estimates for, α_{1jt}, α_{2jt} and α_{3jt} for the model. This study measures discretionary accruals using the Modified Jones Model. Discretionary accruals are estimated from the following model:

$$TAC_{ijt} = \alpha_{1jt}\left[\frac{1}{TA_{ijt-1}}\right] + \alpha_{2jt}\,(\Delta REV - \Delta REC) + \alpha_{3jt} PPE_{ijt} + \varepsilon_{ijt} \quad \text{.............. (i)}$$

Where:
TAC_{ijt} = total accruals for sample company i in industry j at period t scaled by lagged assets;
TA_{ijt-1} = lagged assets, total assets for sample company i in industry j at period t −1;
ΔREV_{ijt} = change in net revenues for sample company i in industry j at period t ;
ΔREC_{ijt}= change in net receivables for sample company i in industry j at period t;
PPE_{ijt}= Gross property plant and equipment for sample company i in industry j at Period t;
$\alpha_{1jt}, \alpha_{2jt}, \alpha_{3jt}$ = coefficients of the regression model;
ε_{ijt} = random error term

$$DAC_{it} = \left|TAC_{it} - T\hat{A}C_{sijt}\right| \text{ .... (ii)}$$

The apriori expectation is that when there is a decrease in the value of discretionary accruals it will result in the increase in performance of deposit money banks in Nigeria.

4. Results and Discussion

This section deals with the presentation, analysis, and interpretation of the results on the effect of earnings management on the financial performance of deposit money banks in Nigeria. It also discusses the results so that inferences can be drawn. Table 4.1 below shows the descriptive statistics and subsequently results of regression analyses for pre and post International financial Reporting Standards adoption periods by deposit money banks in Nigeria.

Table 4.1 Descriptive Statistics of the data

	Mean	Std. Deviation	N
LNROA	2.7070	1.32720	80
LNDAC	6.2273	2.63232	80
LNBANKSIZE	11.8973	2.77889	80
LNGROWTH	5.5465	4.12459	80
LNLEVERAGE	2.7893	2.72930	80

Source: Authors computation (2018)

Table 4.1 shows that ROA has a mean of 2.7070 which is the lowest mean comparing to other measures in the table above; and a standard deviation of 1.32720 respectively. From the table 4.1 that size of the banks has a mean of 6.2273 with 2.632332 as standard deviation. Also, revealed that the mean growth of the DMBs is 5.5465 percent with 4.12459 as standard deviation. Lastly, financial leverage shows the mean of 2.7893 and standard deviation of 2.72930.

Table 4.2 Results of Regression Analysis showing the effects of Pre and Post IFRSs Adoption

	Pre			**Post**		
Variable	Coefficient	t-statistics	p-value	Coefficient	t-statistics	p-value
LNDAC	-1.039	-3.083	.004	-1.137	-2.980	.005
LNBANKSIZE	.664	1.344	.188	-3.411	-5.618	.000
LNGROWTH	1.091	1.563	.127	-3.895	-4.485	.000
LNLEVERAGE	.154	1.039	.306	-.134	-1.027	.311
Adj.R^2	.303				.561	
Durbin Watson	1.983				1.523	

Source: Authors computation (2018)

From table 4.2 above, on pre- IFRS era, accrual-based earnings management measured by discretionary accrual has a negative significant relationship by its coefficient of -1.039 and p-value of .004 which is significant considering the acceptable alpha range of 0.5%. An Adjusted R^2 of 30.3% indicated that the research independent and control variables account for 69.7% of the variations in the dependent variable. Durbin Watson of 1.983 shows that there is no first-order autocorrelation among the residuals in the model.

In the post-IFRS adoption, accrual-based earnings management has a negative significant relationship with a standardized coefficient of -1.137 and p-value of .005 which is less than 0.5% acceptable range of alpha. Bank size and bank growth have a negative significant relationship with coefficients of -3.411, and -3.895 and p-value of .000 for both measures respectively. This correlation is supported by a p-value of 0.000 < p-alpha of 0.05. From the above, bank size and growth influenced performance as measured by return on assets; this validates the correlation drawn above. Financial leverage has insignificant influence and also the Adjusted R^2 of 56.1% indicates that 56.1 percent of the variation in Return on Assets margin can be explained by variability in explanatory variables.

Table 4.3: Results of Regression Analysis Combined Effects.

Variable	Coefficient	t-statistics	p-value
LNDAC	-.667	-2.205	.031
LNBANKSIZE	-.195	-.432	.667
LNGROWTH	.286	.444	.658
LNLEVERAGE	.037	.319	.751
Adj.R^2	.477		
Durbin Watson	1.637		

Source: Authors computation (2018)

The results in table 4.3 above revealed that accrual-based earnings management has a negative significant relation with return on assets represented by a coefficient of -.667 and p-value of .031, this is validated by p< 0.5%. The Adjusted R^2 of 47.7% percent of the variation in return on assets margin can be explained by variability in explanatory variables as well as control variables in the model. Durbin Watson value of 1.637 asserts that there is no first-order autocorrelation among the residuals in the model.

4.1 Test of Hypotheses

Hypothesis 1 examines the relationship between accrual-based earnings management and returns on assets before and after IFRS adoption by deposit money banks in Nigeria. Considering the results presented in table 4.2 with respect to the coefficient of the variable LNDAC "proxy for earnings management" (-1.039, -1.137) and its p-value (.004, .005) for pre-IFRSs adoption and post- IFRS adoption respectively. From these values, both periods have significant negative relationship with firm return on assets with an acceptable alpha range of 0.5%. According to the presented theoretical framework, the greater the extent of earnings management using accounts manipulation through accounting methods, the return on assets will reduce. The evidence above suggests that there is a significant relationship between discretionary accruals and performance of deposit money banks in Nigerian. Therefore, the null hypothesis is rejected. Hypothesis 2 assesses the relationship between accrual-based earnings management and return on assets of deposit money banks in Nigeria. Results from table 4.3 revealed that there is a significant negative relationship between the earnings management and return on assets as attested by the standardized coefficient (-.667) and p-value (.031) respectively. Therefore, the null hypothesis is rejected.

The results of the two hypotheses above are in line with the findings of Saidi & Rubie (2013) but at variance with the findings of Hauwa, Ocheni & Jamila (2017).

5.Conclusion and Recommendations

The aim of the study was to examine the relationship between accrual-based earnings management and return on assets and also to assess the effect of earnings management practices on the return on assets before and after IFRS adoption by deposit money banks in Nigeria. Earnings management practices include: recognizing premature or fictitious revenue, capitalization and extended amortization policies, misreported assets, and liabilities, getting creative with income statement and problems with cash flow reporting. Similarly, the greater the extent of earnings management, using accounts manipulation through the accounting methods, the more the return on assets will reduce.

From the above findings, which show the influence of earnings management on the key performance indicator (ROA), it can therefore, be concluded that earnings management has significant negative relationship on the performance of DMBs in pre and post periods of International Financial Reporting Standards (IFRSs) adoption in Nigeria. Bank-size and bank-growth have a positive significant relationship on return on assets of post-IFRS adoption period. Findings from the combination of the two periods (Pre and Post), revealed the significant negative relationship between earnings management and return on assets of deposit money banks in Nigeria. From the findings, there was existence of earnings management in Nigeria's deposit money banks. However, it is pertinent to note here that the existence of earnings management in DMBs in Nigeria does not have a significant influence on the performance of DMBs as inferred from the findings of this research.

Based on the findings of this study, future studies could extend the literature using other variables, such as Return on equity (ROE) and Economic Value Added (EVA) as proxies for firm performance and examine their association with accrual-based management. It is therefore recommended that appropriate and proper measures should put in place for adequate evaluation, examination and scrutiny of DMBs financial statements. Procedures for early detection of earnings management practices should also be put in place before earnings management practices will have a great and notable negative influence on their performance.

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