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Management of Listed Consumer Goods companies in Nigeria: An Empirical Analysis

Foluke Rachael, Oduwole & Chukwudumebi C, Ajao
Department of Accountancy, Federal Polytechnic Ilaro, Ogun State, Nigeria
foluke.oduwole@federalpolyilaro.edu.ng; chukwudumebi.ajao@federalpolyilaro.edu.ng

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Abstract

The study examines the effect of audit tenure, auditor type (Big 4) on the earnings management of Nigerian companies with particular reference to the consumer goods sector. Audit tenure, audit fees, and auditor type were used to represent audit quality, while accrual was used to measure earnings management of the firms under study. Data sourced from annual reports were extracted between the years 2015 and 2019, descriptive statistics, correlations, and multiple regressions were used to analyze the data collected. Findings revealed that audit tenure has no significant effect on earnings management, audit fees affect earnings management and audit firm type (Big 4) has a significant effect on earnings management of companies involved in the study. The study recommends that the quality of audit reports should not be primarily based on the audit fee as the result of the study shows a negative relationship between audit fees and audit quality.

Keywords: Audit Quality, Earnings Management, Audit Fee, Accruals and Audit Firm Type

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1. Introduction

Financial reports are supposed to deliver relevant and reliable information to the stakeholders of an organization for informed decision-making. It is, therefore, important that the report should convey true and accurate information; However, in a situation where financial information does not represent true and accurate financial position of the entity, wrong decisions are likely to be made by the shareholders and every other potential investor. Managers sometimes use their discretion in choosing which accounting number(s) to use, this might be a decision based on their own personal advantages and this in return makes the differentiation between opportunistic earnings and legitimate exercise difficult (Dechow & Skinner, 2000 and Kothari, 2000). As a result of the vital role of the external audit process in ensuring the dependability of the information contained in financial statements and the extent of their representation of the reality of the company, as well as their ability to reduce information asymmetry between the various relevant parties, the demand for audit quality increased (Birjandi, 2015).

The main goal of audit process is to enable the auditor to express his technical and neutral, opinion with regard to the nonexistence of material misstatements from the financial statements and it`s faithful representation about all important aspects of company (IAASB, 2013). This results to increase in confidence of users of financial statements and also improves the ability to rely on information from financial statements in making various economic decisions. Accordingly, it is illustrated that there are many positive effects for high audit quality, which has positive impacts on the different stakeholders. In that context, previous studies indicated the presence of negative correlation between increasing audit quality and earnings management practices, because of the ability of high audit quality in enhancing the likelihood of discovery those practices, and restricting opportunistic behavior of managers, and then

reducing those practices, as well as minimizing the level of manipulation in the annual profit (Okolie & Izedonmi, 2014; Kwon *et al.*, 2014; Birjandi *et al.*, 2015; Ching *et al.*, 2015; Goodwin and Wu, 2015; Nawaiseh *et al.*, 2016). This reflected positively on the decisions of the financial statement users like shareholders and potential investors.

Along the same line, previous studies indicated the positive effects of high audit quality on the market value of the company, and increasing stock returns, which represent a positive indicator about the company to investors (Okolie & Izedonmi, 2014; Aobdia *et al.*, 2015; Birjandi *et al.*, 2015). Also, one of the studies found that high audit quality has an effect on decreasing the cost of borrowing, which is reflected in increasing external funding opportunities for the company (Aobdia *et al.*, 2015). There are different reasons that motivate managers to manage reported earnings. According to extant literature, some of the reasons for earnings manipulation include increment in share prices (Schipper, 2018), meeting of performance-based competition target (Bergstresser & Philippon, 2016), avoiding debt covenant violations (DeFond & Jiambalvo, 2014), and manipulating earnings around equity offerings such as IPO and seasoned equity offerings. Though several reasons can be given for earnings management, Healy and Wahlen (2014) categorized these motives into four main groups. These are capital market incentives, management compensation contracts incentives, debt contract incentives, and political and regulatory requirements incentives. The relationship between reported accounting earnings and stock prices in the capital market has a potential influence on managers‟ ability to engage in earnings management.

In more advanced economies such as UK and US where the capital market is efficient, investors depend on analysts‟ forecasts in selecting the portfolio of their investments from potentially successful firms. Meeting analysts‟ expectations in such capital markets is very important. Firms which succeed in surpassing analysts‟ expectations attract higher returns on their stocks, even when it is likely that the expectations are reached through earnings manipulations (Bartov & Mohanram, 2014). Missing analysts‟ forecasts for instance, in efficient capital markets have severe negative consequences for stock returns of publicly traded firms (Matsunaga & Park, 2014). This is because investors consider firms which miss analyst forecasts as being riskier than those that meet forecasts expectations. Consequently, when pre-managed earnings are less than forecasted earnings, managers are likely to manage earnings upwards to boost reported earnings. On the other hand, when pre-managed earnings are above analysts‟ forecasts, managers manipulate earnings downwards to defer some returns to future reporting periods (Habbash, 2015). Management compensation contracts also provide incentives for earnings manipulation of firms. Agency theory suggests that management compensation contracts could align the interests of shareholders with managers and minimize agency costs such as earnings manipulation. This is because management compensation contracts serve as monitoring and bonding contracts between managers, and shareholders of the firm (Habbash, 2015). Management compensation contracts are often tied to accounting numbers to observe whether the contract conditions are breached or not. However, when managers‟ compensation is tied to financial performance, managers are likely to make accounting choices that increase income so as to maximize the value of their bonus rewards (Watts & Zimmerman, 1986). This implies that performance-based compensation plans have an unintended consequence over managers, as it motivates them to engage in earnings management to boost their rewards.

Previous research confirms the positive association between earnings-based compensation plans and managers' opportunistic behavior. For example, Healy (2015) found evidence that managers manage earnings so as to upsurge cash compensation when bonus rewards are tied to the financial performance of the firm. Also, Leuz, Nanda & Wysocki (2013) provided similar evidence in support of the association between performance-related reward and managers ‟opportunistic behavior. Therefore, management compensation plans tied to firm performance, provide incentives for managers to manipulate reported accounting earnings upwards in order to maximize their rewards at the expense of other stakeholders. Agency cost of debt to an organisation is reflected in the clash of interest between

managers and shareholders. This cost as suggested by Jensen and Meckling (1976) must be monitored and while a bonding contract is signed such as writing restrictive covenants in debt agreements which includes payment of dividends by management, issue of new debt and allowing debt holders to demand early repayment of their debt before achieving the minimum accounting numbers may so as not to be borne by shareholders and managers (Habbash, 2010). Though debt is a cheap source of financing compared to equity, according to the debt covenant hypothesis (Watts & Zimmerman, 2017), more debts impose more restrictive conditions on the borrowing firm. The firm is therefore, under constant pressure to avoid violation of restrictive debts covenants associated with borrowing. But when highly indebted firms are close to violating these debt covenants, they resort to making income-increasing accounting choices to boost reported earnings (Bello & Yero, 2011) in a bid to avoid costs associated with debt violation. Managers of firms close to violating debt conditions are therefore, more likely to manipulate accruals in order to avoid costs associated with debt covenant violation.

Managers sometimes manage earnings because they are influenced by regulatory and political cost requirements. Regulatory requirements related to accounting numbers could provide the incentive for earnings management in public firms. Tight regulatory conditions in some countries put reporting firms under constant pressure and often influence them to manage reported earnings upwards. For instance, stringent listing requirements of some stock exchange provides incentives for earnings manipulation. Managers of firms listed on such exchanges often resort to manipulates earnings when they are close to violating listing regulations in order to remain listed on the stock exchange. Empirical evidence such as Haw, Qi, Wu & Wu (2015) and Johnson and Rock (2015) supported the positive relationship concerning regulatory requirements and earnings management of public firms. The relationship between political costs and managerial opportunism is confirmed by many empirical studies such as Guay (2010), Kurdi (2010), Chen, Li, Liang & Wang (2011) and Braam, Nandy, Weitzel & Lodh (2015).

The stakeholder theory views the firm as a nexus of relationships. Freeman (1984), cited in Schilling (2000) defines a stakeholder as "any group or individual who can influence or is influenced by the achievement of the organization's objectives". In the words of Clarke (2014), stakeholder theory defines the firm as multilateral agreements between the enterprise and its multiple stakeholders. Unlike the agency theory which reduces the stakeholders in a firm to only shareholders and managers, stakeholder theory views the firm as comprising more than two stakeholders (e.g. employees). A company's employees, managers and owners (regarded here as internal stakeholders) have a relationship with the company which are established over the years. Customers, suppliers and the community (here referred to as external stakeholders) also have a very important relationship with the organisations. This relationship too could be guarded by formal and informal rules which the organisations need to obey. Thus, stakeholder theory recognizes the fact that business organisations and the society are interdependent. The firm hence serves a broader social purpose than its responsibilities to only shareholders and managers as proposed by the agency theory (Kiel & Nicholson, 2013).

Habbash (2015) investigated the effect of external auditor quality and corporate governance attributes on earnings management in UK. Using a sample of 350 companies on London Stock Exchange to investigate the relationship between external audit attributes and earnings management, the study documented evidence that independent and specialized external auditors are negatively associated with earnings management of the sampled firms at significant levels. The result suggested that both auditor independence and auditor industry specialists impact negatively on earnings management of UK firms. Findings from the study may not apply to Nigerian companies generally due to different economic and legal conditions faced by companies in the two countries.

Gerayli, Yanesari & Ma'atoofi (2017) investigated the relationship between audit quality and earnings management in Iran using 540 companies between 2004-2015. The dependent variable, discretionary accruals was estimated

using the modified-Jones model (Dechow, Sloan & Sweeney, 2015) while multiple regression analysis was used to analyze the data collected. The findings indicated that discretionary accruals are negatively related to auditor size, auditor industry specialization and auditor independence measured by audit fees. The result implies that firms audited by high quality auditors are more likely to have less discretionary accruals than firms audited by lower quality auditors. The study is limited because even though both Iran and Nigeria are developing economies, the findings of the study may not apply to oil marketing companies in Nigeria due to some peculiar economic, sectoral and legal differences in the two countries. Additionally, the study excluded audit committee attributes from the measurement of audit quality and so failed to test the interaction effect of internal and external governance variables on earnings management of firms.

Hegazy (2015) examined the effect of audit firm specialization on earnings management in Egyptian firms. A sample of seventy (70) auditors, comprising both specialist auditors and non-specialist auditors were given a common task with the same time to perform under the supervision of a professor of auditing and three (3) senior practicing auditors. Findings at the end of the experiment indicated that industry specialists restrain earnings management not better than non-specialist auditors. The study is however, limited because even though both Egypt and Nigeria are developing economies, differences still exist that could make the findings of the study not applicable to listed oil marketing in Nigeria. Besides, extending the sample size of the study beyond seventy (70) auditors may likely change the outcome of the study. Also, the non-scientific selection of the study sample makes the study findings doubtful.

In another study, Yasar (2013) assessed the impact of audit quality on earnings management of companies listed on Turkish Stock Exchange for the period 2003-2007. Empirical evidence from the regression analysis indicated that a positive relationship exists between audit firm size and discretionary accruals of manufacturing firms in Turkey. This evidence implies that audit quality does not constrain earnings management in Turkey. The result of the study is however, limited because given the economic differences between Turkey and Nigeria findings from the study are not likely to apply to oil companies in Nigeria. Also, the study focused on only audit firm size and excluded many important attributes of audit quality such as auditor industry specialization which extant literature suggests could mitigate earnings management.

Some of the studies carried out on the audit quality and the management of earnings include Imen & Pascal (2014), Lin & Hwang (2010) and Habbash (2010) which were conducted in UK, Australia and Europe respectively. However, most studies carried out in developing countries including Nigeria did not make use of audit firm type (Big 4) as an audit attribute. To the best of the researchers' knowledge, some studies conducted in developed countries such as (Lin & Hwang, 2010; Imen & Pascal, 2014; Habbash, 2010) and one Nigerian study conducted by Abubakar (2014) made use of is audit firm type (Big 4) to represent audit quality.

With particular reference to the importance of the contribution of the consumer goods companies to the economy of Nigeria and the fact that the sector has been labeled with manipulative tendencies, it becomes necessary to study the earnings management behaviour of the sector and estimate the extent of this association. The current study is an attempt to further assess the impact of external audit quality on earnings management of listed consumer goods firms in Nigeria using audit firm type (Big 4), audit tenure, and audit fees as the measurement of audit quality and accruals quality as a proxy for earnings management with data from some listed consumer goods firms in Nigeria. Therefore, it aims at assessing the impact of audit quality on the management of earnings of Nigerian firms with particular reference to the consumer goods sector using proxies such as audit tenure, audit fees, and audit firm type (Big 4).

2. Materials and Methods

This study employs the descriptive statistics research design (such parameters as range, mean, standard deviation, correlation, and regression analysis) for an adequate description of the data collected, to assess the relationship between the variables and to evaluate the impact of independent variables on the dependent variable. All the twenty-four (24) listed consumer goods companies in the Nigerian Stock Exchange (as of 31st December 2019) formed the population of this study. The study selected a sample size of five (5) companies using the judgmental sampling technique because of easy availability of data to enhance the research work. Data for the study were sourced from the Published Financial Reports and Accounts of selected consumer goods companies from 2015 – 2019 which covered over a period of five (5) years. The annual reports and accounts are sourced from an internet database and the Nigerian Stock Exchange Fact Book. Data extracted were then analysed through descriptive statistics and inferential statistics on SPSS (Statistical Package for Social Sciences).

Model Specification

The proxy of earnings management is estimated as a function of proxies of audit quality, which have been defined in the study as: Audit Tenure (AT), Audit Fees (AF), and Audit firm type (Big 4). On the other hand, earnings management is represented by Discretionary Accruals (DA). OLS (Ordinary Least Square) regression that was used to assess the relationship is as follows:

$$DA = \alpha + \beta_1 AT + \beta_2 AF + \beta_3 AFT + \mu$$

Where;

D.A = Discretionary Accruals
A.T = Audit Tenure
A.F = Audit Fees
AFT = Audit firm type (Big 4)
μ = Error term.

3. Results

The variables are defined in a multiple regression model for the secondary data and the relationship between them is ascertained. The interpretation of the data shows the usefulness of the data for the research topic.

Table 1: Descriptive Results

	N	Mean	Std. Deviation
DA	15	-.0179	1.69678
AT	15	10.0000	2.23607
AF	15	5.4345	1.19078
AFT	15	.8667	.35187
Valid N (listwise)	15		

The table presents the result of the mean and standard deviation of the variables. From the mean, it is observed that AT is a good predictor of DA with the mean of 10.0000 compared to 5.4345 and 0.8667 for AF and AFT respectively. This means that the statement with the highest mean can best be used to predict the dependent variable.

Table 2: Analysis of Variance

Model		Sum of Squares	DF	Mean Square	F	Sig.
1	Regression	19.509	3	6.503	3.439	.056[b]
	Residual	20.798	11	1.891		
	Total	40.307	14			

a. Dependent Variable: DA
b. Predictors: (Constant), AFT, AF, AT

The table above shows a significance level of 0.56 which implies that the variables tested is significantly insignificant as the result is slightly above 0.5 of the approved significance level at 95% confidence level.

Table 3: Correlation Results

		DA	**AT**	**AF**	**AFT**
DA	Pearson Correlation	1	.220	.467	-.227
	Sig. (2-tailed)		.432	.079	.416
	N	15	15	15	15
AT	Pearson Correlation	.220	1	.071	.363
	Sig. (2-tailed)	.432		.801	.183
	N	15	15	15	15
AF	Pearson Correlation	.467	.071	1	.294
	Sig. (2-tailed)	.079	.801		.287
	N	15	15	15	15
AFT	Pearson Correlation	-.227	.363	.294	1
	Sig. (2-tailed)	.416	.183	.287	
	N	15	15	15	15

Table 4: Regression Result

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. error	Beta		
1	(constant)	-5.235	2.300		-2.276	.044
	AT	.283	.177	.373	1.601	.138
	AF	.854	.323	.599	2.642	.023
	AFT	-2.597	1.171	-.539	-2.218	.049

a. Dependent Variable: DA

4. Discussion

Table 5 above shows the coefficients of the model. The model, which is given as:

$$DA = \alpha + \beta_1 AT + \beta_2 AF + \beta_3 AFT + \mu$$

It can be described as follows:

$$DA = -5.235 + 0.283\text{AT} + 0.854AF - 2.597AFT + \mu$$

A positive relationship is revealed in the regression table above among AF, AT and DA. Meanwhile AFT and DA show a negative association with each other. The implication of this is that a unit rise in AF and AT will cause about 0.283 and 0.854 increases in DA respectively. However, a unit increase in AFT will cause DA to decrease by 2.597. Their probability values are shown as 0.138, 0.023 and 0.049 respectively. The probability value for AT is insignificant at 5% significant level while that of AF and AFT are significant at 5% significant level.

Interpretation of Results

The result of the analysis can be given below as:

Hypothesis one

Ho_1: Audit tenure has no significant effect on earnings management of listed consumer goods firms in Nigeria

Table 5 presented earlier is considered suitable to treat the research assumption stated above. From the coefficient table, the probability value is shown as 0.138, which can be interpreted to be statistically insignificant as the value derived is greater than 5% significance level. It can therefore be concluded here that audit tenure has no significant relationship with earnings management of the companies studied. The result of this study is supported by the studies of Chinwe & Chinwuba (2015), Adeyemi *et al.* (2015), Molik, Mir, Mclver & Bepari (2013), Rohaida (2015) and Zhou & Guan (2014).

Ho_2: Audit fee does not affect earnings management of listed consumer goods firms in Nigeria

The regression table reveals an Audit fee (AF) of 0.023 which can be interpreted to be statistically significant as the value derived is less than 5% significance level. With this, the researcher, therefore, rejects the null hypothesis and concludes that audit fee affects earnings management of listed consumer goods firms in Nigeria. This goes in line with the study conducted by Amahalu and Ezechukwu (2017), Enofe *et al.* (2013) and Chinwe & Chinwuba (2015) but against the findings of Adeyemi *et al.* (2015) and Tyokoso & Tsegba (2015).

Ho_3: Audit firm type (Big 4) has no significant relationship with earnings management of consumer goods companies.

The regression table shows an Audit Firm Type (AFT) of 0.049 which can be interpreted to be statistically significant at 5% significance level. This means that the relationship between Audit Firm Type and Earnings management is statistically significant which can be supported by the studies conducted by Rohaida (2015), Zhou and Guan (2014), Karimi & Gerayli (2014) and Memis (2018) but not in line with that of Chinwe & Chinwuba (2015), Adeyemi *et al.* (2015) and Tyokoso &Tsegba (2015).

5. Conclusion

The findings reveal that audit tenure has a probability value shown as 0.138, which was interpreted to be statistically insignificant as the value derived is greater than 5% significance level. With this, the researcher concludes that audit tenure cannot be relied upon in the prediction of earnings management. In addition, it is revealed that the audit fee has a sig-value of 0.023, which was interpreted to be statistically significant at 5% significance level. As a result of this, one can conclude that earnings management (represented by discretionary accrual) of the selected firms cannot be predicted with the use of audit fees.

Lastly, the findings reveal that audit quality represented by audit firm type (AFT) has a probability value of 00.049 which can be interpreted to be statistically significant at 5%. The researchers, therefore, conclude that audit firm type (Big 4) has an influence on the variable tested under study.

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