

Non-Executive Directors' Attributes and Earnings Management of Listed Oil and Gas Marketing Firms: Evidence from Nigeria

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Abstract

Non-Executive Directors (NEDs) are considered to be efficient in enhancing corporate governance and business prosperity of companies. Despite many studies on the effect of board attributes on earnings management yet, few studies explored the net effect of non-executive directors' attributes on earnings management. Thus, objective of the paper was to investigate the effect of non-executive directors' attributes (fees, meetings attendance, multiple directorships and competency) on earnings management (discretionary accruals) as estimated by Modified Jones (1995) models and performance matched discretionary accruals by Kothari, Leone & Wasley (2005) model. The study used robust Ordinary Least Square regression to analyse 77 firm-year observations of listed oil and gas marketing firms in Nigeria from 2012 to 2017. The study found that fees paid to NEDs have a significant positive impact on earnings management. However, NEDs' average meetings attendance and multiple directorships were found to have significant negative effect on earnings management. While, competency of the NEDs does not have significant impact on earnings management. Therefore, based on this, the study concluded that, NEDs usually compromise their monitoring role in order to protect their seat to serve for longer tenure when their fees is high and consequently reduce financial reporting quality. It also confirmed that meeting attendance is more guaranteed for effective monitoring than frequent meetings without too much attendance. It is further recommended that the proportion of NEDs holding multiple directorships should be encouraged since directors who serve on more than one board can have more experience and knowledge about corporate board. This experience can be transferred from one board to another and consequently assist them in constraining earnings management. The finding of the study provides an initial insight into the net effect of NEDs attributes (i.e. excluding executive directors) on earnings management. It also considered NEDs fees (which is different from board remunerations) and its relationship with earnings management.

Keywords: Earnings Management, Non-executive directors, Fees, Meeting attendance, Competency.

Introduction

As a result of the separation of ownership and control of investment in modern day business activities, financial statement serves as a major medium of communication between management and shareholders. The shareholders view performance of their investment through financial statement being prepared by the management. However, progression of accounting scandals like those of Enron (2000), Worldcom, Pamalat, Xerox (2001), Satya Computer service India, Tyco International, GlaxoSmithKline (2012), Target (2013), Olympus (2013), Toshiba (2015), Volkswagen emission scandal (2015), Oando Nigeria plc (2017) and collapse of some reputable companies from the beginning of this century across the globe has become a thing of concern. Investors and other users of financial statement have begun to question the reliability of the financial statement for decision making, as it is not reporting what is supposed to have been reporting (Armeyau, 2019; Miko, 2016; Idris, 2014; Shehu & Abubakar, 2012). All this resulted from alteration of financial statements linked to earnings management.

Incidence of earnings management has become rampant and widespread among publicly listed companies around the globe since from the beginning of this century. Many CEOs and team of executive directors have been accused and convicted with

financial scandals related to financial statements' alteration through earnings management. Alteration of financial statements mislead stakeholder in ascertaining companies' real performance to enable them make accurate investment decision. Biddle, Ma and Song (2012) are of the opinion that the demise of some giant companies like Enron (2000), Xerox, Worldcom (2000) around the globe were as a result of earnings management. This created a negative inference with regard to stock price valuation from the side of many users. The collapse of these giant companies drew the attention of corporate governance reform around the globe. Consequently, the Sarbanes Oxley Act was introduced in 2000 by the United States to tackle the situation.

As earlier mentioned, incidence of earnings management is widespread; and companies in Nigeria are not free from this opportunistic behavior. Cases of financial scandals had been witnessed and some cases are still under investigation (Akenbor & Ibanichukwu, 2012). Of recent, Oando Nigeria plc was accused with financial statement alteration. According to Sahara reporters (July 15, 2017), an investigation triggered by the petition filed by two of Oando shareholders, the Security and Exchange Commission's investigators found evidence of earnings management. It was reported that the company has been cooking its books for the past six

years, creating impression that it was making a profit when in fact the company was swimming in debts and overburdened by mismanagement. The question that remains unsolved is: how do earnings management continue to be spreading even with the several reforms regarding corporate governance codes, accounting standards and financial regulations? The monitoring role of board of directors has been questioned as to what corporate board should be constituted in order to have sound board that can constrain earnings management practice to restore investors' confidence.

One of the major roles of board of directors is to monitor and reduce the incidence of earnings management (Hashim, Ariff & Salleh, 2013). Thus, it is observed that earnings management is triggered by weak and poor corporate governance, and that board of directors were mostly held responsible for failure to monitor and control the activities of managers effectively. The essence of monitoring or controlling a firm by BOD is to resolve agency conflict that usually arises. However, financial scandals in some giant companies forced countries over the world to emphasize on NEDs and supervisory directors as efficient in enhancing business prosperity (Mendes, 2015).

Nigeria have gone through a series of reforms to improve code of corporate governance for companies. SEC code

provided that NEDs should dominate at least two-third of corporate board in Nigeria. According to Habbash (2010), an increase in the proportion of NEDs on corporate board can improve corporate governance practice and its monitoring function. He explained that stockholders have been mounting pressure on their firms to reduce the number of executive directors with the hope that NEDs provide more objective monitoring and oversight function of financial reporting procedure. Fama (1980) argues that NEDs serves as referees between shareholders and managers. Therefore, more representation of NEDs provides monitoring role of the firm's financial reporting process. According to Fama and Jensen (1983), NEDs have incentive to protect their personal reputations by monitoring managerial opportunistic behavior effectively.

Prior studies showed that there is a linkage between board of directors and earnings management. The current study provides an alternative way of assessing board of directors' characteristics. Most previous studies measured board characteristics in lump-sum without distinguishing between executive and non-executive directors' characteristics. However, separate characteristics have not been examined thoroughly. For instance, in measuring expertise most executive directors have accounting knowledge.

The present study tries to focus mainly on the attributes of non-executive

directors and their influence on earnings management. This is because, despite their role in entrenchment of good corporate governance, little attention was given to some of their attributes in relation to earnings management. Attention was mostly given on independent NEDs and proportion of NEDs to total board members. However, characteristics such as NEDs' fees, NEDs' competency, NEDs' meeting attendance, NEDs' interlocking, Foreign NEDs and NEDs' gender mix were given less attention. The study examined some unique variables namely: NEDs' fees, NEDs' meeting attendance, NEDs' interlocking and NEDs' competency to see their impact on earnings management. The study used NEDs fees as a sign of commitment. This is because, previous line of study (Habbash, 2010) indicates that NEDs are likely to commit themselves to their monitoring role over financial reporting processes when their fees (remuneration) is high. The study also used an alternative measure of board meeting by assessing the average meeting attendance of non-executive directors instead of frequency of board meeting only.

This study focused on studying the impact of NEDs' characteristics on earnings management of oil and gas marketing firms. The reason for chosen the sector was triggered by recent case of accounting scandal in Oando Nigeria Plc (being belong to oil and gas sector). Oando Nigeria plc was

accused with financial statement alteration as petitioned by two shareholders (in 2017) and the Security and Exchange Commission's investigators found evidence of earnings management. And that this was attributed to poor corporate governance adherence (Armayau, 2019). The study adopted performance match accrual model by Kothari *et al.* (2005) to measure earnings management. The choice of the period is because, it is the period (from 2012) that listed companies in Nigeria were authorized to report financial statement based on IFRS; which many people believe to be more robust. In the same vain, SEC amended corporate governance code was introduced in 2011 to start effect in 2012. Therefore, it is not out of place to conduct empirical study of this kind to access the role of NEDs in determining the level of discretionary accrual of the said firms.

The study would be helpful to investors and regulators in knowing whether NEDs effectiveness and role in providing robust and reliable financial statement is attainable or otherwise. The empirical finding would enable regulators (like SEC) to understand whether the heavy weight placed on NEDs in constrain earnings management feasible or otherwise. This would help in designing future policy and guides on the role of NEDs in corporate boards in Nigeria. The study further adds to the body of literature on the effect of NEDs'

characteristics on earnings management for reference matters.

Following the introductory aspect of this paper, the next section is literature review and theoretical framework; section three entails methodology and model specification; section four discussed about the results and findings; while the last section is about conclusions and recommendations.

Literature Review and Hypotheses Development

Based on the established linkage between variables of the study, the paper aimed at examining the impact of NEDs' attributes on earnings management of listed oil and gas companies in Nigeria; while the specific objectives were to determine the effect of NEDs' fees, meeting attendance, multiple directorship and competency on discretionary accruals of listed oil and gas companies in Nigeria. The relationship between earnings management and board of directors' characteristics have been conceptually and empirically examined by different researchers. The findings and conclusions varied from one country to another and from different domain to another in the same region. That is, there was no consensus on the findings and conclusions due to different statistical results and opinion of researchers. This can be attested from the empirical review conducted. As such, literature were reviewed and hypotheses were also developed based on the established fact in the literature.

NEDs Fees and Earnings Management

NEDs fees is an indication of NEDs' efforts and commitment (Habbash, 2010) towards their monitoring function. He argued that previous line of reasoning indicates that NEDs are likely to commit themselves to their monitoring role over financial reporting processes when their fees (remuneration) is high. According to Hampel report (1998), NEDs remuneration can be used as a mechanism to align the interest of shareholders with that of directors. Mallin (2007) suggested that NEDs should be paid a fee that commensurate with their role. This will enable them to dedicate their time to perform their oversight and monitoring function.

Habbash (2010) studied the effectiveness of corporate Governance and external audit on constraining earnings management practice in the UK. The study used a sample of top 350 firms. NEDF was measured as the percentage of total fees paid to NEDs divided by total number of NEDs. The result showed that NEDs' fees has a significant negative relationship with earnings management. This is in tandem with the notion that NEDs are effective in monitoring accrual management and that firms that pay high fees to NEDs tend to be less involved in earnings management.

Adams and Ferreira (2004) in their study using a panel data to examine directors' attendance at meeting. The companies examined were listed public companies during the period 1996-2003. The study found strong evidence that directors participate and attend meetings when board meeting fees are high. They observed that NED perform their duties even with little stipend.

Jensen (1989) suggested that NEDs who are rewarded with share option in a firm are more likely to have commitment to monitor executive directors than those without such equity ownership. The study argued that NEDs can intensify their effort on monitoring financial reporting process when high fees is paid by the firms. Therefore, it is expected to resort to low earnings management when the stipend is high. With this, the study hypothesized that:

H₀₁: NEDs fees does not have significant effect on earnings management of listed oil and gas marketing firms in Nigeria.

NEDs' Meetings Attendance and Earnings Management

There is a lot of criticism by many financial and academic publications on Board of Directors for not attending Board Meetings regularly; and which by extension may lower their ability to monitor management well (Modugu & Dabor 2013). The levels of board interaction

and activities have influence on Earnings Management. Boards that normally meet often are more likely to solve the problems of the company effectively (Lipton & Lorsch, 1992).

Most previous studies used frequency of board meetings as measure of boards' commitment and activity. But the current study used average meeting attendance by NEDs. Carcello, Hermanson, Neal and Riley (2002) observed that for board meetings to be effective, consideration should be given to other factors like preparation before the meetings, attendance of the meetings and the action taken after the meetings based on the issues raised.

Habbash, Salama and Dixon (2008) suggest that some prior studies measured board commitment in term of participation in board meetings, activity fee and NED private meeting. This indicates that frequency of meetings held does not always guarantee quality financial information but meeting attendance does. When board members, especially non-executive directors participate fully in the meetings of the company, there is tendency that they would deliberate on crucial issues that would guarantee quality financial statement. The level of meeting attendance by board of directors matters a lot. This is because even if the frequency of meeting is high but the level of attendance is poor, then the level of monitoring can also be poor (Mbobo & Umoren, 2016). Board that rarely meets may not

have the time to focus on issues such as earnings management (Habbash *et al.* 2008). Jaiswal & Bernajee (2012) have empirically found that meeting attendance by board member resort to low earnings management.

Mbobbo & Umoren (2016) found a significant positive relationship between audit committee meeting attendance and financial reporting quality. Jaiswal & Banerjee (2009) examine the relationship between Earnings Management and corporate governance characteristics in the Indian context. The result suggests that more number of board meetings and higher attendance in these meetings resort to lesser Earnings Management.

Empirical researches produced different findings. For instance, Zhou & Chen (2004) and Xie, Davidson and Dadalt (2003) found evidence of significant negative relationship between board frequency of board meeting and earnings management. In their study, Gulzar & Wang (2011) found evidence of significant positive relationship between earnings management and board frequency of meetings. Meaning that more board meeting can resort to lower financial reporting quality.

On the other hand, studies by Moradi, Salehi, Bighi & Najari (2012), Sukeecheep, Yarran, Al-Farooque (2013), and Kantudu & Ishaq (2015) did not found any evidence of significant relationship between

earnings management and board frequency of meetings.

The current study focused on meeting attended by NEDs not number of meetings held. This is for the fact that not all the time that NEDs attend board meetings due to other commitments. Therefore, the study hypothesized as follows:

Ho₂: NEDs meetings attendance does not have significant effect on earnings management of listed oil and gas marketing firms in Nigeria.

NEDs' Interlocking and Earnings Management

The SEC Code (2011) offers that concurrent service on too many boards of dissimilar companies may hinder with the discharge of a director's responsibility and that this factor should be taken into consideration. From this standpoint, it is anticipated that earnings management will drop when the average number of extra directorships held by the directors of the firm is greater. According to Barzuza and Curtis (2015), a director may take comfort in another board's choice, good or bad, and approve a similar decision at his own firm. Interlocks could also assist outside directors who would otherwise suffer from an informational disadvantage, by spreading information about good governance practices and giving directors broader insight into the general state of the economy. Interlocks, thus, could empower

outside directors in their monitoring activities. According to Jamaluddin, Sanusi and Kamaluddin (2015), a director is said to be holding multiple directorship/interlocked when he/she concurrently serves in more than one firm's team of board of directors. They stated that this kind of director tend to be more knowledgeable about managerial experience. As such, they might have the opportunity to read and understand earnings manipulation and offer better monitoring role.

Some researches such as that of Ferris, Jagannathan and Pritchard (2003), Devos, Prevost and Puthenpurackel (2009), Jiraporn, Singh and Lee (2009), and Falato, Kadyrzhanora and Lei (2014) showed that holding multiple directorships can reduce the time and the efforts of directors to execute their oversight functions and it can increase the level of earning management and reduce firm performance. Based on that they advise the regulators to impose restriction on the number of non-executive directors holding multiple directorship in order to make them more effective in discharging their monitoring functions. Proponents of multiple directorships believe that more outside directors serving under more than one board would have more experience on board related issues. While on the other hand others argue that such directors might be less committed due to lack of time and efforts.

Based on this, directors holding multiple directorship can be effective in monitoring financial statement, because of the experience they have. While on the other hand, their monitoring function might be compromised for being overburden with multiple board activities and increase the level of earnings manipulation through accrual earnings management.

Chandren, Ahmad and Ali (2015) have empirically examined the relationship between the corporate governance mechanisms and accretive share buybacks of Malaysian firms from 2001 to 2008. The regression results of the study report the significant effect on the relationship between corporate governance and accretive share buyback. Using the accretive share buyback as an earnings management proxy, multiple directorships and managerial ownership documents a negative relationship with accretive share buyback. Baccouche, Hadriche and Omri (2013) after examining the impact of audit committee multiple directorships and earnings management of quoted 88 non-financial French companies in 2008, documented a positive relationship between audit committee multiple directorships and earnings management. They opined that audit committee can't provide effective monitoring of earnings management when its members held many additional outside directorships. In other words, if the audit committee

members undertake on average an additional number of outside directorships, the level of earnings management increase.

Hashim and Abdul Rahman (2014) examined the relationship between interlocked directors and earnings quality (measured by standard accrual quality residuals). Using a sample of 554 firm-years of observation spanning 2003 to 2004, found that interlocked directors are associated with higher accrual quality as measured by accrual quality models. It shows that the presence of interlocked directors on a board provides an incentive for diligent monitoring as they have the knowledge, expertise, skill and stronger incentive to actively monitor the actions of management and improve the quality of financial reporting. The relationship however, appears non-linear. Too many members in a firm with interlocking directorates appear to deteriorate the quality of earnings.

Fadzila (2017) examined the relationship between board of directors' characteristics and earnings management among Malaysian family owned companies. The study used 184 family owned companies that are listed on main market of Bursa Malaysia from 2009 to 2012 with total observations of 736 companies' years. Two measurements of discretionary accruals (modified Jones Model and Performance matched discretionary accruals model) are selected to

calculate earnings management. In testing the relationship, the study uses ordinary least square regression and the finding indicates that multiple directorships have no significant impact on earnings management.

The effect of multiple directorships on real earnings management therefore, becomes an empirical matter. Based on these conflicting arguments and different statistical finding, the study formulated the following hypothesis:

Ho₃: NEDs multiple directorship has no significant influence on earnings management of listed oil and gas marketing firms in Nigeria.

NEDs' Competency and Earnings Management

Competencies focus on what is expected of person in the work place and his or her ability to transfer and apply knowledge and skill to their work. Previous researches show that directors appear to require various clusters of competencies (Yusoff & Armstrong, 2012). Studies on board of directors' competencies started in the United Kingdom upon the establishment of Cadbury Report in 1992. Cadbury (1992) states that non-executive member that is competent is of special importance for effectiveness of the board.

Increase in the proportion of non-executive directors does not guarantee the effectiveness of board monitoring. But what guarantee it is competency. NEDs must possess the necessary

competency to carry out their control and overseeing duties, among which knowledge of company specific affairs is particularly essential (Chtorou, *et al.* 2001). Competencies include functional and specific knowledge, skills and educational qualification that are necessary to enable directors to perform their role of monitoring top management (Yusoff & Armstrong, 2012). Agrawal & Chada (2001) argue that manipulation of earnings tends to be low for firms with directors who have knowledge in accounting and finance.

In a survey carried out by Yusoff & Armstrong (2012), eight types of competencies were ranked to be necessary and significant for Malaysian companies' directors. However, accounting and finance knowledge was ranked to be the most essential competencies for directors. This provides evidence that directors' knowledge of accounting and/or finance should have significant effect on earnings management.

Bala & Gugong (2015) examined the influence of board characteristics on earnings management of listed food and beverages firms in Nigeria. The study found an evidence of inverse relationship between earnings management and directors' financial expertise. In the same vain, Lin & Hwang (2010) found significant negative effect of board expertise on earnings management. Also, Agrawal & Chada (2001) find that earnings manipulation in the US is low in firms

with board members who have accounting and finance knowledge. This is an indication that directors are required to have accounting knowledge to be able to effectively constrain earnings manipulation.

In contrast, Yusof (2009) investigates to find out whether the Malaysian code of corporate governance (MCCG) has achieved its goal in improving the quality of earnings among firms. The study uses a sample of 190 KLCI components over a 4 years period from 1998 to 2003. The sample is divided into two categories namely pre-MCCG and post-MCCG periods. The study employed modified Jones (1995) model to calculate discretionary accruals. In the post-MCCG, the result shows a significant positive association between board competencies and discretionary accruals. Matawee (2013) also found a significant positive relationship between board financial expertise and earnings management.

On the other hand, Bunamin, Johari, Abd Rahman and Abdul Ra'uf (2012) in their study, found that board competency did not have significant impact on discretionary accruals. Also, Johari, Jaffar and Hassan (2008) analyzed the influence of board independence, competency and ownership on earnings management in Malaysia. By using dichotomous variable of 1 if a firm has at least one director that has professional qualification in accounting or finance,

and 0 otherwise as a measure of board competency, while discretionary accruals was used as a measure of earnings management for a sample of 234 firms listed on the Bursa stock exchange over the period 2002-2003. The result revealed a non-significant relationship between knowledge as well as experience of the board members and earnings management activities.

Moreover, Cadbury (1992) states that non-executive member that is competent is of special importance for effectiveness of the board. Increase in the proportion of non-executive directors does not guarantee the effectiveness of board monitoring but its competency. Outside director must possess the necessary competency to carry out their control and overseeing duties, among which knowledge of companies' specific affairs is particularly essential (Chtorou, Bedard & Courteau, 2001). Agrawal & Chada (2001) and Yusoff & Armstrong (2012) argue that manipulation of earnings tends to be low for firms with directors who have knowledge in accounting and finance. Based on this the study hypothesized that:

H₀₄: NEDs competency does not have significant impact on earnings management of listed oil and gas marketing firms in Nigeria.

Theoretical Framework

The agency theory is based on principal-agent relationship. In a modern listed public firms, the owners

(shareholders) are not the ones running the affairs of their investment. Rather, it is being controlled by the agents known as managers. The expectation is that this management would act based on the interest of shareholders. Usually, the medium of communication between them is financial statement being prepared by the management. However, due to separation of ownership and control as well as information asymmetry, management might prepare financial statement that suit their purpose. According to Jensen and Meckling (1979), the separation between ownership and control might result to potential conflict of interest. And for a firm to resolve such conflict, then there is need for it to incur some cost by appointing board of directors to monitor managerial activities.

Managers have incentive to manage earnings to achieve predetermined target at the expense of shareholders. For instance, they can manage earnings to meet some profit target or to receive bonus. Depending on the nature of manipulation, the net effect would be on the corporate financial reporting. Davidson, Stenning and Wai (2004) believe that once management mislead shareholder by providing manipulated financial statement, then it results to earnings management as type of agency cost.

In order for shareholders to minimize such conflict of interest they should appoint their representatives who would monitor management

opportunistic behavior i.e. board of directors. Board of directors are seen as fundamental to protecting shareholders interest from being compromised when managers maximise their self-interest at the detriment of the firm financial reporting process. According to Habbash (2010), NEDs who happened to lack personal relationship with management constitute effective corporate governance structures to control managers opportunistic behavior. Requirements for monitoring suggest the need for the use of NEDs (Fama, 1980).

From the perspective of agency theory, earnings management is a problem that can result to dispute between shareholders and management. As such, stringent and sound corporate governance should minimize the level of earnings management. Therefore, when NEDs are given power and independence they might perform their monitoring function effectively and also reduce the level of information asymmetry. The influence of NED attributes such fees, meeting, interlocking and competencies are expected to be used to minimize the agency conflict and protect shareholders interest.

Methodology and Model Specification

The study adopted correlational research design by employing both descriptive and inferential statistics using regression analysis. A

correlational study tries to measure the degree of relationship between one or more variables for making predictions about relationship.

The population of the study comprises of all the 14 listed oil and gas firms on the Nigerian Stock Exchange as at 2017. These includes: Anino International Plc, Beco Petroleum Product Plc, Capital Oil Plc, Conoil Plc, Eterna Plc, Forte Oil Plc., Japaul Oil & Maritime Services Plc, Mobil Oil Nig Plc., Mrs Oil Nigeria Plc., Navitus Energy Plc, Oando Plc, Rak Unity Petroleum Company Plc., Seplat Petroleum Development Company Limited, Total Nigeria Plc.

The study used secondary source of data. The data were collected from the annual reports and account of the sampled companies, Nigerian stock exchange factbook and directors' personal information from their personal websites, facebook accounts and LinkedIn (this is where directors profiles were not given in detail in financial statement and seems to be relevant for our analysis, for instance directors' professional qualifications, con-current directorships).

The dependent variable is the discretionary accruals estimate that measures the extent of accruals earnings management. The study determined earnings management using two models-the modified Jones model developed by Dechow *et al.* (1995) (which is the most common used model to calculate discretionary accruals) and

the performance-adjusted model of Kothari et al. (2005); which is an upshot of Dechow *et al.* (1995) model. It control for firms' with extreme performance as the return on asset is introduced in the model.

The cross-sectional earnings management model of Dechow et al. (1995) is chosen because it has been widely adopted by researchers to estimate extent of abnormal accruals. The performance-adjusted model of Kothari et al. (2005) is chosen as an alternative earnings management model because it uses the lagged return on assets to control the performance of the business. As such, it alleviates heteroskedascity problems and avoids the specification problems associated with modified models when it comes to estimating discretionary accruals.

The model of Kathori, Leone and Wasley (2005) has been used to estimate abnormal accruals by incorporating the performance of assets (ROA) to the Jones Modified model. Dechow, et al. (1995) stated that the probability of type I errors tend to be high significantly high when the original Jones and Modified Jones models are used in situations where the performance of the firm is excessive. Therefore, it is considered that the bias is eliminated from the original of Jones.

The first model used (Modified Jones model) is presented below:

$$TAC_{it}/TA = \alpha (1 / TA_{it-1}) + \beta_1 (\Delta REV_{it} - \Delta REC_{it}) / TA_{it-1} + \beta_2 (PPE_{it} / TA_{it-1}) + \epsilon_{it}$$

The second model (of Kothari et al. (2005) used is presented below:

$$TAC_{it}/TA = \alpha (1 / TA_{it-1}) + \beta_1 (\Delta REV_{it} - \Delta REC_{it})/TA_{it-1} + \beta_2 (PPE_{it} / TA_{it-1}) + \beta_3 ROA_{it-1} + \epsilon_{it}$$

Where

$TAC_{it} = NI_{it} - CFO_{it}$

TAC= Total accruals

NI_{it} = is the earnings before extraordinary items of firm i in year t

CFO_{it} = is the net cash flows from operating activities of firm i in year t

ΔREV = Change in revenue (sales)

ΔREC = Change in receivable

PPE = Gross plant, property and equipment

ROA = Return on asset

TA = Total asset

After regressing for the above two equations, the residual value (ϵ_{it}) obtained, represent discretionary component of the total accrual. Therefore, the absolute values of the residuals represent discretionary accruals (earnings management). Multiple regression was used to analyse the relationship between NEDs' specific characteristics and earnings management of listed oil and gas companies.

Model specification

The essence of the model is to ascertain the impact of NEDs' characteristics on earnings

management of listed oil and gas firms in Nigeria. In addition, the study includes two control variables: board size and firm size. The statistical inferences were drawn using these models:

$$\text{Modjones}_{it} = \beta_0 + \beta_1 \text{NEDF}_{it} + \beta_2 \text{NEDMD}_{it} + \beta_3 \text{NEDMA}_{it} + \beta_4 \text{NEDC}_{it} + \beta_5 \text{BS}_{it} + \beta_6 \text{FS}_{it} + \mu_{it}$$

$$\text{Kothari}_{it} = \beta_0 + \beta_1 \text{NEDF}_{it} + \beta_2 \text{NEDMD}_{it} + \beta_3 \text{NEDMA}_{it} + \beta_4 \text{NEDC}_{it} + \beta_5 \text{BS}_{it} + \beta_6 \text{FS}_{it} + \mu_{it}$$

Where:

Modjones = absolute value of discretionary accruals obtains from modified Jones (1995) model

Kothari = absolute value of discretionary accruals obtains from Kothari et al. (2005) model

NEDF = NEDs' fees

NEDMD = NEDs' multiple directorship

NEDMA = NEDs' meetings attendance

NEDC = NEDs' competency

BS= Board size

FS = Firm size

μ = Error term

$\beta_0 - \beta_6$ = parameters (slope coefficient)

it = firm 'i' year 't'

Table 1 Variables Measurement

Dependent Variable	Measurement
Modjones	The absolute values of discretionary accruals (residual obtained from Dechow <i>et al.</i> (1995) model
Kothari	The absolute values of discretionary accruals (residual obtained from Kothari <i>et al.</i> (2005)
Independent Variables	
NEDs fees	Natural log. of the ratio of total fees paid to NEDs divided by total number of NEDs (Habbash, 2010)
NEDs multiple directorship	Number of NEDs concurrently serve under more than one corporate board
NEDs meetings attendance	Average meeting attendance by NEDs (Habbash, 2010)
NEDs' competency	Proportion of NEDs with accounting or finance qualification (Johari et al. (2008) and Idris (2014)
Control Variables	
Board size	Number of board of directors
Firm size	Natural log. of total assets

Source: Compiled by the author (2018)

Results and Discussion

Table 2 presents descriptive statistics of the variables of the study. The mean, standard deviation, minimum,

and maximum was used to describe the data.

Table 2 Descriptive Statistics

Variables	Obs	Mean	Std.Dev.	Minimum	Maximum	Skewness	Kurtosis
Modjones	60	0.0478	0.0842	0.0001	0.4612	3.8364	17.6396
Kothari	60	0.0597	0.0841	0.0003	0.4589	3.5301	15.7971
NEDF	60	14.9594	0.5181	13.6820	15.8628	-0.3569	2.5888
NEDMA	60	0.8606	0.1414	0.5023	1.0000	-0.9081	2.9586
NEDMD	60	0.5008	0.0995	0.2233	0.6667	-1.1699	4.1635
NEDC	60	0.2965	0.0776	0.1000	0.5000	-0.3834	3.2049
BS	60	11.5167	2.1589	7.0000	15.000	-0.2574	2.1451
FS	60	23.0455	1.7927	18.6023	27.5938	0.1981	2.9063

Source: Stata output

The absolute value of discretionary accruals as obtained from modified Jones (1995) and Kothari *et al.* (2005) models shows a minimum value of 0.0001 and 0.0003 (which are much closer to zero) and a maximum of 0.4612 and 0.4589 respectively. The mean values for Modjones is 0.4612 while that of Kothari is 0.4589. The minimum values indicate that some firms did not manage earnings. The standard deviations are 0.0842 for Modjones and 0.0841 for Kothari. This indicates that the deviation between companies is quite large as the standard deviation is greater than the mean values. The discretionary accrual values are above zero, which suggests the existence of earnings management in the listed oil and gas firms in Nigeria.

are N8,229,375 and N17,325,000 respectively.

The meetings attendance by NEDs (NEDMA) during the period was measured by the ratio of the number of meetings attended divide by number of meetings held to the total number of NEDs. The mean value of 0.8606 indicated that the sample companies averagely attended 86% of the board meetings held during 2012-2017. The minimum attendance was 50% (0.5033) while the maximum attendance was 100% (1.000). The standard deviation of 0.1414 suggested that there was no huge disparity from the mean. It indicated the deviation between companies is low. That is, most of the firms conform with 86% attendance.

The average fees received by NEDs between 2012-2017 was N15,305,925. The minimum and maximum amounts

The multiple directorship (NEDMD) measured by the number of NEDs concurrently serving more than one

corporate board to total NEDs. It showed a mean value of 0.5008, suggesting that 50% of NEDs held multiple directorship at the same time during the period 2012-2017. The minimum value of 0.2233 signified that some sampled companies had minimum of 22% of NEDs that served on more than one corporate board, while, the maximum value of 0.6667 suggested that some firms had up to 67% of NEDs that served under more than one corporate board. The standard deviation was 0.0995, indicating that the deviation from mean between companies was very low.

The NEDs Competency (NEDC) is measured by the proportion of NEDs who have qualification in accounting and/or finance to total NEDs. From the table 2, the board competency has a mean of 0.2965, a minimum of 0.1 and a maximum of 0.5000. This indicates that in each board of the sampled companies there was at least one NED with qualification in accounting and/or finance. It also appeared that 10% to 50% of the NEDs during the period 2012-2017 were competent. This shows that there were NEDs who are competent during the period of the study.

The board size (BS) was used as a control variable. The BS has a mean of 11.5167 with a standard deviation of 2.1589, a minimum of 7 and a maximum of 15. This shows that the number of board of directors between the companies differ. There is an expectation that the magnitude of earnings management will differ across the companies due to influence on the number of board members. On average, the sampled firms reported had approximately 12 board members. The second control variable is firm size proxies by natural logarithms of total assets. It has a mean of 23.0455 with standard deviation of 1.7927 and the range is from a minimum of 18.6023 to a maximum of 27.5938.

Correlation Analysis

The correlation matrix is used to determine the degree of association between independent variables and dependent variable. It is also used to identify whether there is a relationship among the independent variables themselves, to be able to detect if multicollinearity problem exists.

Table 3: Correlation matrix

Variables	Modjones	NEDF	NEDMA	NEDMD	NEDC	BS	FS
Modjones	1						
NEDF	0.0732	1					
NEDMA	-0.4085*	0.0985	1				
NEDMD	-0.5784*	0.1060	0.0800	1			
NEDC	-0.1212	0.0001	0.0105	0.1487	1		
BS	0.0890	-0.4039*	-0.2016	0.0149	0.1673	1	
FS	-0.1038	0.2962	0.0958	0.0177	0.2273	-0.0357	1

Source: Extract from Stata output

Table 4: Correlation matrix

Variables	Kothari	NEDF	NEDMA	NEDMD	NEDC	BS	FS
Kothari	1						
NEDF	0.0592	1					
NEDMA	-0.3916	0.0985	1				
NEDMD	-0.6520	0.1060	0.0800	1			
NEDC	-0.1138	0.0001	0.0105	0.487	1		
BS	0.1121	-0.4039	-0.2016	0.0149	0.1673	1	
FS	-0.0800	0.2962	0.0958	0.0177	0.2273	-0.0357	1

Source: Extract from Stata output

Looking at the correlation coefficients in table 3 and 4, NEDMA is negatively and significantly correlated with DAC which was measured by modified Jones (1995) model. On the other hand, there is also significant relationship between NEDMA and discretionary accruals measured by Kothari *et al.* (2005). In the same vain, NEDMD is also negatively and significantly correlated with DAC of listed oil and gas companies in Nigeria during the period 2012-2017 in both the models. NEDF and BS show weak positive correlations with discretionary accrual; while NEDC and FS show weak negative association with DAC of the sample firms.

It is clear that there is no high correlation among the explanatory variables in the two models. It is only Board size (-0.4039) and Firm size (0.2962) appear to have moderate correlation with NEDs' fees. All these variables are included in the same model since the correlations are not strong, which are lower than 0.80. According to Gujarati (2003) a correlation between independent variables should not be too high. He recommends 0.80 as the threshold at which multicollinearity problem may threaten the regression analysis.

Further analysis was done to ascertain whether the problem of

multicollinearity would make our statistical inference less valuable. For that, Variance Inflation Factor (VIF) tests were carried out.

The analysis on the two models shows that the VIF values are within acceptable limits. The result shows the VIF and tolerance value of each explanatory variable. Gujarati (2003) suggests that a VIF value of less than 10 is acceptable; therefore, the

maximum VIF value in the model is 1.34. The mean of VIF for the both models is 1.17. Thus, multicollinearity does not appear to be a problem.

Diagnostic Tests

To avoid making wrong inferences, some diagnostic tests were conducted and the summary of the statistical result can be depicted from table 5 below:

Table 5 Summary of diagnostic tests

Diagnostic tests conducted	Model 1(Modjones)		Model 2 (Kothari)	
	Statistics	P-Values	Statistics	P-Values
Hettest-Chi2	64.28	0.0000	40.51	0.0000
Mean VIF	1.17	-	1.17	-
Hausman-Chi2	1.74	0.9418	2.54	0.8643
LMTRE-Chi2	0.16	0.3447	0.001	0.4724

Source: **The Authors, 2018**

LMTRE is ‘Breusch and Pagan Lagrangian Multiplier Test for Random Effect’

In order to test for heteroskedasticity in the data, the study used Breusch-Pagan and Cook-Weisberg test for heteroskedasticity. In model one, the chi-square value is 64.28 and the probability value is 0.0001 which suggests presence of heteroscedasticity. On the other hand, in model two, the test also revealed presence of heteroskedasticity, as the chi2 value is 40.51 and the p-value is 0.0001. In addition to that, multicollinearity test was also conducted using VIF and tolerance values (1/VIF). No multicollinearity

threat was found; as the VIF of each independent variable is within accepted limits; that is, they are consistently less than 10 as suggested by Gujarati (2003). The mean VIF for both the models is 1.17.

The study conducted test for fixed and random effect regressions. The Hausman Test (HST) revealed that random effect was more appropriate for both model one and two. This is because of the Chi2 values of 1.74 and 2.54 with p-values of 0.9418 and 0.8643 respectively. The study extended the test to see whether there is a statistical variance among the unit in the panel data. To test for that, ‘Breusch and Pagan Lagrangian

Multiplier Test for Random Effect' was used and the test result revealed that there was no statistical significant variance among the unit in the panel data for both the two models. This can be observed from the chi2 values of 0.16 and 0.001 and P-values of 0.3447 and 0.4724 respectively. Thus, this suggests that OLS technique is more appropriate for the two models. But if we recall from the initial test for heteroscedasticity, we found evidence of its presence. Therefore, in order to correct for that, the study would use Robust OLS regression to draw inferences.

Hence, the inference was drawn from the results produced by the robust OLS regression

Regression Analysis

The study used two dependent variables and are obtained using two step regressions (that is, residuals obtained from Modified Jones, 1995 and Kathori et al. 2005 models). Therefore, the regression results are presented below on the effect of NEDs attributes on earnings management (discretionary accruals):

Table 6 Summary of Regression Results

Variables	Model 1 (Robust OLS)			Model 2 (Robust OLS)		
	Coefficient	t-statistics	P-Value	Coefficient	t-statistics	P-Value
Constant	-0.0737	-0.32	0.753	-0.0722	-0.30	0.766
NEDF	0.0421	2.17	0.035	0.0413	2.22	0.031
NEDMA	-0.2080	-2.97	0.005	-0.1917	-2.83	0.007
NEDMD	-0.4855	-3.24	0.002	-0.5504	-4.36	0.000
NEDC	-0.0277	-0.32	0.752	-0.0175	-0.20	0.840
BS	0.0051	1.29	0.204	0.0062	1.63	0.109
FS	-0.0059	-1.11	0.273	-0.0049	-0.07	0.289
F-statistics	2.41	-	0.0391	3.03		0.0044
R-square	0.5214	-	-	0.5940	-	-

Source: Extract from Stata output

Table 6 shows that both model 1 and 2 shows that NEDF (nonexecutive directors' fees) has a significant positive impact on earnings management of listed oil and gas firms in Nigeria at 5% level. This signifies that an increase in fees paid to NEDs can lead to corresponding increase in

earnings management through discretionary accruals. The beta coefficient of 0.0421 for model 1 and 0.0413 for model 2 suggest that an increase in fees paid to NEDs by 1% can leads to an increase in earnings management by approximately 4%. However, the finding is attributed due

to the fact some NEDs might compromise their monitoring function when they are paid high, in order to conceal management unethical act so as to be recommended for longer tenure on the board. This is contrary to prior literature line of reasoning which suggest that NEDs are likely to commit themselves to the monitoring role over financial reporting processes when their fees (remuneration) is high (Habbash, 2010). Furthermore, the t-statistics of 2.17 and 2.22 and the P-values of 0.035 and 0.031 respectively indicate that NEDF has a significant positive on earnings management and hence provides a basis to reject the null hypothesis that says NEDF has no significant impact on earnings management of listed oil and gas firms in Nigeria. The finding contradicts that of Habbash (2010).

The regression results for both the models further revealed that NEDMA has a significant negative impact on earnings management of listed oil and gas firms in Nigeria at 1% level. This can be observed from the t-statistics of -2.97 and -2.83 with corresponding p-values of 0.005 and 0.007 respectively. This shows that an increase in the board meetings attendance by NEDs significantly reduces the earnings management of listed oil and gas firms in Nigeria. This signifies that frequency of board meetings held would not be effective if consideration is not given to meeting attendance. The finding is supported by the assertion put by Carcello et al. (2000), who

states that for board meetings to be effective, consideration should be given to attendance of the meetings and action taken after the resolution. Also, Modugu & Dabor (2013) stated that irregular meeting attendance by board of directors lower the ability to monitor management effectively. The beta coefficient, -0.2080 for model 1 and -0.1917 for model 2 signifies that earnings management might reduce by 20% and 19% respectively with an increase in the level of meetings attendance by NEDs. The study further provides an evidence to reject the null hypothesis that NEDMA does not have significant impact on earnings management of listed oil and gas firms in Nigeria. The finding in tandem with those of Habbash (2010) and Mbobo and Umoren (2016).

The finding also suggests that NEDs multiple directorship (NEDMD) significantly and negatively affect earnings management listed oil and gas firms in Nigeria at 1% level as revealed by the two models. This shows that effective monitoring and constraining of discretionary accruals reduce with an increase in the proportion of non-executive directors that concurrently serve on more than one board. This finding can be confirmed from the t-statistics of -3.24 and -4.36 and the p-values of 0.002 and 0.001 respectively. The beta coefficients suggest that discretionary accruals reduce by 0.49 and 0.55 respectively with an increase in one more NEDs that serve under more than

one board. According to Jamaludden (2015), this kind of directors tend to be more knowledgeable on managerial experience and thus offer better monitoring role. The finding also leads to reject the null hypothesis which states that NEDMD has no significant effect on earnings management of listed oil and gas firms in Nigeria. The finding of the study is in line with those of Chandren, Ahmad and Ali (2015) and Hashim & Abdul Rahman (2014). It is contrary to that of Baccouche, Hadriche and Omri (2013) who found positive relationship; while Fadizila (2017) did not find evidence of significant relationship.

The regression results reveal that NEDs competency (NEDC) has no significant impact on earnings management of oil and gas firms in Nigeria in both model 1 and 2. This can be confirmed by the t-values of 0.0277 and -0.20 with significant values of 0.752 and 0.840 respectively. This shows that NEDs' qualification in accounting or finance does not have any significant impact on the earnings management of the sampled companies. This is contrary to what have been suggested in some literature which shows that members of board of directors who have accounting and/or finance' background are better able to reduce earnings management. The finding serves as a base for failing to reject the null hypothesis which states that NED does not have significant impact on earnings management of listed oil and gas firms in Nigeria. The

finding is in tandem with those of Johari et al. (2008), Buamin et al. (2012) and Xie et al. (2003) who also found insignificant impact of board competency on earnings management. It is however, contradicts the finding of Agrawal and Chada (2001) who found that earnings manipulation in the US is low in firms with board members who have accounting and finance knowledge.

Furthermore, the F-statistics was used to test the fitness of the model. Based on the result, it shows that the two models are fit. This is because, the F-statistics for model 1 and 2 are 2.41 and 3.63 while the corresponding P-values are 0.0391 and 0.0044 respectively; though, model one is significant at 5% while model two is at 1%. In addition, the R-square which measure extent the explanatory variables explained the variation in the dependent variable, show values of 0.5214 for model one and 0.5940 for model two. This signifies that the explanatory variables (both independent and control variables) explained the earnings management of listed oil and gas in Nigeria to the extent of 52% and 59% respectively, while the remaining 48 and 41% respectively are explained by other factors not captured in the models. In line with this, it is concluded that NEDs' characteristics has a significant effect on earnings management of listed oil and gas firms in Nigeria.

Conclusions and Recommendations

The study concludes that NEDs compromise their monitoring role in order to protect their seat and serve for long tenure when their remuneration is high. It confirmed that meeting attendance by directors ensure effective monitoring than the number of meetings. Also the directors who serve on more than one board have more experience and knowledge about corporate board. This experience can be transferred from one board to another and consequently assist them in constraining earnings management.

In line with the findings and conclusions of this study, it was recommended that the corporate organizations should make appointment of non-executive to be based on merit by setting some criteria for the appointment, like qualification, and the ability to analyze financial data. In addition, the proportion of NEDs interlocked should be dominant in the board, so as to share different ideas as regard to their experience on multiple directorship. Finally, better measure of directors' diligence, such as attendance at meetings, and participation in the meeting should be considered for inclusion in future code of corporate governance and disclosure requirements of the companies by Security and Exchange Commission in Nigeria.

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