DETERMINANTS OF EARNINGS MANAGEMENT IN NIGERIAN QUOTED COMPANIES

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ABSTRACT

The objective of this study was to examine the determinants of earnings management using selected quoted companies in Nigeria. The study adopts a cross-sectional research design with an extensive reliance on secondary data from the financial statement of quoted company's annual report. The simple random sampling technique was employed in selecting the 30 companies for 2007-2014 financial years. Secondary data sourced from financial statements of quoted companies retrieved from the Nigeria Stock Exchange and websites of the sampled companies will be utilized for the study. The study will make use of ordinary least squares (OLS) regression analysis as the data analysis method. In this study we adopted OLS regression techniques to examine how the explanatory variables (Corporate governance, firm size, audit firm type and financial performance) impact on earnings management using discretionary accruals measure. The study finding indicates the existence of negative significant relationship between board size, audit firm type and earnings management In addition, they study also found the existence of a non-significant relationship between firm size, ROA and earnings management. The recommendation is that there is the need for companies to consider the need to increase their board independence. Again companies must ensure that the auditors' they engage are credible and have a track record of delivering reports that show the actual state of affairs of a company. Finally, Financial Reporting Council should have stiffer penalty for companies caught engaging in the act of earnings management.

Key Words: Earnings Management, Firm size, Audit firm type, Corporate Governance
Jel Codes: M4 & M41

INTRODUCTION

The basic objective of financial reporting is to provide information about an enterprise that is useful to a wide range of users in making economic decision. However, the validity of this objective is being questioned by man users of corporate financial reports because of the probable effects of earnings management on information contents of such reports. Hence creating is a growing issue of concern, threatening the credibility of both the accounting and auditing functions. While the problem of creating accounting is not new, it was one of the key themes in corporate finance and corporate governance in the 1980s (Merchant and Rocknes 1994). By the early 1990s, earnings management was well and truly recognized by national and international regulators as one of their major challenges of financial reporting and it has developed geographically both in its practices' complexity and in its nomenclature. Thus, the term preferred in the USA and the most frequent one is that of "earnings management" where as in Europe the phrase "creative accounting" is often used. In the literature, creative accounting can still be found under the name of income smoothing, earnings smoothing, cosmetic accounting or accounting cosmetics, financial crafts or accounting crafts. According to Lin (2006), earnings management involves those techniques which are openly displayed (window dressing) as well as those which are sophisticated ones (off-balance sheet financing). Merchant and Rockness (1994) defines earnings management as any action from management which can distort profits and which is not a consequence of the economic reality, it actually represents the privilege of the financial engineering. Thus, the economic entity is presenting to the investors or to the prospective investors financial statement passed through the filter of some techniques capable of generating a more favourable image on the market but also the illusion of some more attractive results. A firm can intentionally alter reported financial results, i.e., income statement and statement of cash flows, or reported financial position, i.e., the balance sheet, in some desired amount and/or some desired direction.

Earnings management is primarily accomplished through accounting transactions that are designed to achieve desired earnings level. Prior research suggests that managers have both personal and business motivations to display impressive or at the very least satisfactory performance in their reports on a consistent basis (DeFond and Park, 1997; Greenfield, Carolyn, Norman, and Wier 2008). However, due to a variety of reason, the sustainability of such a performance is sometimes impossible. In these circumstances managers may decide to use their discretions in the application of accounting principles and procedures which can result in altering the business operations to a more favorable outcome. In the Nigerian corporate environment the presence and negative effect of earnings management on credibility of financial reporting and corporate failure has also been experienced for example, a report of creative accounting scandal in African Petroleum PLC showed that the financial statements of the company did not fairly present the company's financial position (Oyejide and Soyibo, 2001). In November 2006, an accounting scandal in Cadbury Nigeria Plc also raised more questions than answer about creative accounting (Itsueli, 2006). Also, earnings management practice has been increasing in recent years in the Nigerian banking industry to attract unsuspecting investors, or obtain undeserved accounting-based

rewards by presenting an exaggerated misleading or deceptive state of bank financial affairs. There is the need for the subject of earnings management in the accounting profession eliciting considerable concern form arras a wide range of stakeholders and this forms the basis for the study.

The problem that has formed the motivation for the research is that firstly, we find that the tendency for earnings management has been witnessed amongst companies in Nigeria and this suggest that earnings management is fast becoming a key challenge for stakeholders in the Nigerian Corporate setting. The banking sector challenges which saw the Economic and financial Crimes Commission (EFCC) summoning the top management of the banks as a result of fraudulent financial reporting, which has affected the stability of the financial system suggest to us that the threat of earnings management already lurks around. The implication is that there will be the gradual emergence of skepticisms in the mind of investors, shareholders and other stakeholders on the credibility of financial reporting reports of companies in Nigeria. Hence the study will help to bring the issues of creative accounting to the fore with a view to providing research based recommendations. Secondly, previous studies on creative accounting such as Sen and Inanga (2004), Domash (2002), Amat, Blake and Dowds (1999) Naser (1993), Schiff (1993), and Alam (1988) have focused mainly on the impact of creative accounting on investors' decisions in the stock market without highlighting the factors that may determine that likelihood or otherwise of creative accounting. Even studies conducted in Nigeria such as Ibanichuka and Ihendinihu (2012), Effiok and Eton (2012) and Abiodun, Sunday, Stephen and Gabriel (2012), Salome, Ifeanyi, Ezemoyih, & Echezonachi (2012) did not examine the determinants of the tendency for earnings management. Hence this study fills this gap by examining the possible determinants of earnings management practices.

OBJECTIVE OF THE STUDY

The following are the objectives of the study

1. To examine the relationship between financial performance and earnings management
2. To investigate the effect of corporate governance on earnings management
3. To evaluate the relationship between firm size and earnings management.
4. To examine the relationship between auditor type and earnings management

HYPOTHESIS OF THE STUDY

HO_1 There is no relationship between financial performance and earnings management

HO_2 Corporate governance has no effect on earnings management

HO_3 There is no relationship between firm size and earnings management

HO_4 There is no relationship between auditor's type and earnings management

2. LITERATURE REVIEW AND HYPOTHESES

2.2 Concept of Earnings Management

Defining earnings management through its practices, Shah (1996) as well as almost in the same manner, Trotman (1993) defines earnings management as a communication techniques having in view the amelioration of the information provided to the investors. Thus, the economic entity is presenting to the investors or to the prospective investors financial statements passed through the

filter of some techniques capable of generating a more favourable image on the market but also the illusion of some more attractive results. A firm can intentionally alter reported financial result, i.e. income statement and statement of cash flows, or reported financial position, i.e. the balance sheet, in some desired amount and/or some desired direction.

Healey and Wahlen, (1999) notes that earnings management undermines financial reporting quality when managers use judgments in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying performance of the company or to influence contractual outcomes that depend on reported accounting numbers.

Similarly, Schipper (1989) notes that earnings management results in low quality financial reporting resulting from a purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain. These definitions take an opportunistic view of creative accounting as the basis for level of reporting quality whereby the intent of management is to obtain some private gain by misleading stakeholders or influencing contractual outcomes. Therefore, under this perspective, earnings management negatively impacts on the quality off earnings, i.e., the greater the extent of creative accounting practices, the lower the earnings quality and vice versa. If earnings were managed opportunistically, the reported earnings number and the overall financial reports would be of a lower quality.

Filed, Sullivan and Lin (2001), state that earnings management is witnessed when managers exercise their discretion over accounting numbers, with or without restrictions. Such discretion can be either firm value maximizing or opportunistic. Thus, there are two types of earning management, opportunistic and informative. Opportunistic creative accounting practices means that managers seek to mislead investor by pursuing the management's interests. The literature on this type of creative accounting mainly originated with Healy (1985) who finds that manager use accruals to strategically manipulate bonus income.

2.2 Measurement of earnings management

2.2.1. Jones (1991) Model

The first measure of financial reporting quality examined is that based on the model developed in Jones (1991). This model focuses on calculating the discretionary portion of total accruals, which is then used as a measure of earnings management. To partition total accruals into its discretionary and non-discretionary components, Jones (1991) used the following expectations model for total accruals to control for changes in the firm's economic circumstances:

$TA_{it} / A_{it-1} = a_i\{1/A_{it-1}\} + \beta_{1i}\{\Delta REV\ 1/A_{it-1}\} + \beta_{2i}\{PPE_{it}/A_{it-1}\} + \varepsilon_{i,t}$

Where: TA_{it} = Total accruals in year t for firm i;

A_{it-1} = Total assets in year t-1 for firm i;

ΔREV_{it} =Revenues in year t less revenues in year t-1 form firm i;

PPE_{it} = Gross property, plant and equipment in year t for firm I;

$\varepsilon_{i,t}$ = Error term in year t for firm i.

The change in revenues and gross property, plant and equipment were included in the above model to control for changes in non-discretionary accruals due to changing conditions. The changes in revenues was included as it was assumed to be an objective measure of the firms' operations before

any manipulation by management, whereas gross property, plant and equipment was included to control for the non-discretionary depreciation expenses (Jones 1991).

2.2.2 Modified Jones Model

This model uses a modification of the original Jones (1991) model as proposed by Francis et al. (2005). They included the change in accounts receivable in the estimation model for normal or non-discretionary accruals (i.e., equation (1) above). This was done based on the reasoning that, not doing so, would produce values for abnormal (discretionary) accruals that are not centred on zero when the mean ΔREV is not zero (Francis et al. 2005). The equation (1) above became

$TA_{it} / A_{it-1} = a_i\{1/A_{it-1}\} + \beta_{1i}\{\Delta REV\ 1/A_{it-1}\} + \beta_{2i}\{PPE_{it}/A_{it-1}\} + \varepsilon_{i,t}$

Where: TA_{it} = Total accruals in year t for firm i; (measured by operating profit after tax-cash flow operations).

A_{it-1} = Total assets in year t-1 for firm i;

ΔREV_{it} = Revenues in year t less revenues in year t-1 form firm i;

PPE_{it} = Gross property, plant and equipment in year t for firm I;

$\varepsilon_{i,t}$ = Error term in year t for firm i

2.3 Determinants of Earnings Management

2.3.1 Financial Performance

In Companies with higher level of profitability, the tendency to engage in earnings management practices may be reduced since the pressure to perform will tend to be reducing than companies with lower level of profitability. According to Stakeholders theory, economic performance of a firm affects management's decisions either engage or not to engage in earnings management accounting practices which will indicate the extent of financial reporting quality. When companies are not performing well, economic demands and the anticipated benefits will determine the nature of the firm's information environment (Roberts, 1992). Ang and chen (2006) argued that firms endogenously choose the level of information and how credible the information could be based on the costs and benefits of direct communications with the market. In this regards, several studies (Darrough and Stoughton, 1990; Feltham and Xie, 1992) hypothesize that a situation of endogenous information asymmetry can be created by the firm if the decision to disclose information to investors is influence by concern that such disclosures can damage their competitive position Freedom & Jaggi (1992) argues that the economic performance (measured by profitability) of firms can influence the level of reporting quality. Thus if management is performing badly financially, the tendency to want to manipulate the reporting process may be higher in order to impress shareholders and potential investors.

Consequently, the study hypothesizes that;

H1: There is a negative significant relationship between financial performance and earnings management.

2.3.2. Corporate Governance

The role of corporate governance is instrumental in reducing the occurrence of earnings management accounting practices and improving the financial reporting process because of the

monitoring roles of corporate governance. Financial reporting quality is dependent function of effective corporate governance system. The premise for this assertion is that the opportunistic tendency of managers to engage in unethical practice is reduced in the presence of effective corporate governance structure. Thus several empirical researches (Fama, 1980; Fama & Jensen, 1983) have linked corporate governance mechanisms to high quality financial report and unlikely hood of creative accounting. Given these developments, there has been an emphasis on the need to improve corporate governance over the financial reporting process. According to Brennan and McDermott, (2004) one of the most important functions that corporate governance can play is in ensuring the quality of the financial reporting process and thus the corporate governance system is an essential factor to consider in the continuum of factors with the potential of influencing accounting quality. Corporate governance focuses amongst others on building strong and effective boards, protecting shareholders and customer' rights, improving the control environment, increasing financial and non- financial reporting quality. According to Bello (2011) Corporate managers have been in recent times, exploiting the loop holes in accounting standards to manipulate earnings. Sanusi (2002), in examining the role of corporate governance in sustaining credibility of accounting outcomes posits that disclosure and transparency are key pillars of a corporate governance framework, because they provide all the stakeholders with the information necessary to judge whether or not their interest are being served.

Consequently, the study hypothesizes that;

H2: There is a negative significant relationship between corporate governance and earnings management.

2.3.3. Firm Size

Firm size is related to the number of resources owned by the company; the size of a firm can be presented by total assets, number of sales, average sale and average total assets. Assets size is considered to be the most appropriate as a proxy for firm size (makaryanawati, 2003).It is often argued the larger the firm the less likely they may want to engage in creative accounting practices and the more likely they will be concerned with improving the quality of financial reporting. The finding is consistent with previous research documenting a positive relation between firm size and disclosure policy decisions (Lang and Lundholdm, 1993) According to O' Donovan, (1997) larger companies come under more scrutiny than smaller companies. These companies thus feel the pressure to disclose more information and improve the quality of financial reporting and thus reduce the level of information asymmetry. Larger firms are also perceived to be important economic entities and therefore have greater demands placed on them to provide quality financial reports (Cooke, 1991). A positive association between size of a cooperation and the extent of has been consistently confirmed by prior studies (Stanny and Ely, 2008; Ho and Taylor, 2007). In addition large firms may also have the resources to put in place effective structures and processes to ensure improved quality reporting.

There seem to be some level of consensus the literature on the positive relationship between the firm's size and the quality of its financial reporting process. The reasons for this according to

studies (Bujaki and Richardson, 1997) is that large firms are more willing to reduce information asymmetry and thus reduce their political costs, since their size makes them quite visible in the coronate environment and could make them easy target for litigation and other regulatory sanctions. Consequently, the study hypothesizes that;

H3: There is a negative significant relationship between firm size and earnings management

2.3.4 Auditor Type

Watts and Zimmerman (1990) consider that auditors play a major role in limiting opportunistic behavior by managements that may result in creative accounting. Watts and Zimmerman (1986) argued that auditors incur costs from entering contracts with audit clients, and so will influence clients to disclose as much information as possible in their annual reports. Nevertheless, empirical studies that examine the between the size of audit firms and the extent of earnings management by companies are contradictory. Craswell and Taylor (1992) found a positive relationship between auditor and the tendency for earnings management identified through low reserve disclosure in the Australian oil and gas industry It is assumed that size (Big 4) of audit firm suggest reputation, international affiliation, and integrity which are reflected in the audit report on the accounts of their clients. It has severally been argued that the large audit firms significantly determine the disclosure of policies of the companies they audit. Studies that have used size of audit firms in measuring the existence of creative accounting and earnings management include Kim, Chung and Firth, (2003) and Krishnan, (2003).

Lennox (1999) looked at the two explanation of why the presence of a BIG 4 audit firm may deter the practice of earnings management. The first explanation was in regards to the "reputation" hypothesis suggested by DeAngelo (1981). The explanation is that large auditors have more incentives to be accurate because they have more client-specific rents to lose if their reports are not accurate. The second explanation is referred to as the "deep" pockets hypothesis used by Dye (1993) who argued that large auditor will be more accurate because they have grater wealth that is exposed to risk in case of any litigation. Consequently, the study hypothesizes that;

H4: There is a negative significant relationship between auditor type and earnings management.

3. THEORETICAL FRAMEWORK

Agency Theory

The agency theory is based on the relationship between the principal (owners) and the agent (managers). The separation of ownership from management in modern corporations providers the context for the function of agency theory. Modern organizations have widely dispersed ownership, in the form of shareholders, who are not normally involved in the management of their companies. In these instance an agent is appointed to manage the daily operations of the company. This distinction between ownership and control creates the potential for conflicts of interest between agents and principals, which result in costs associated with resolving these conflicts (Jensen & Meckling, 1976 and Eisenhardt, 1989).

The most important basis of agency theory is that the managers are usually motivated by their own personal gains and work to exploit their own personal interests rather than considering

shareholders' interests and maximizing shareholder value. Consequently, management has an incentive to manage the company's financial report process in order to meet or beat earning targets and, thus, to receive any bonuses that may be tied to the company's earnings (performance-related pay). This creates an information asymmetry in that managers can exercise the discretion they have on accruals, which in turn reduces the relevance and reliability of reported earnings, and the whole financial statements. Thus, the key predicament indicated by agency theory is ensuring that managers pursue the interests of shareholders and not only their own interests. In order to effectively limit agency costs caused by the separation of ownership and control, Fama and Jensen (1983) propose that firms need a system that can separate decision management from decision control. This would limit agency costs by controlling the power of management and ensuring the proper consideration of shareholders interest.

4. METHODOLOGY AND MODEL SPECIFICATION

The study adopts a cross- sectional research design with an extensive reliance on secondary date from the financial statement and annual reports of companies quoted in the Nigerian Stock Exchange for 2007-2014.The simple random sampling technique was employed in selecting the 30 companies for the study. The technique is well suited for determining the sampling as it provides an equal probability of selection and as such minimizes selection bias. Secondary data sourced for financial statements of quoted companies retrieved from the Nigeria stock exchange and websites of the sample companies will be utilized for the study. The study will make use of multiple Ordinary Least Square (OLS) regression analysis as the data analysis method. In this study we adopted OLS regression techniques to examine how the explanatory variables (corporate governance firm size and financial performance) impact creative accounting. The OLS multiple regressions was adopted because it is the appropriate techniques for examining the relationship between variables (Gujarati, 2009). To ensure that our model is statistical and econometrically valid, we conducted diagnostic test such as goodness fit (R-squared, F-test, t-test etc), heteroskedasticity test and autocorrelation test. However, preliminary analysis such as the descriptive statistics and correlation analysis will also be conducted.

For the purpose of the study an econometric model is specified and estimated.

The functional specification is shown thus;

ERNMGT = f (COG, FSIZE, FINPERF, AUFTYP)

The econometric specification is thus;

$ERNMGT=\beta_0 + \beta_1 COG + \beta_2 FSIZE + \beta_3 FINPERF + \beta_4 AUFTYP + u$

Where;

ERN= Earnings management

COG=Corporate Governance

FSIZE= Firm size

FINPERF=Financial performance

AUFTYP=Audit firm type

u- Error term

Aprori expectation; $\beta_1, \beta_2 < 0, \beta_3 < 0$ $\beta_4 < 0$,

Table 1: Measurement of Variables

S/N	VARIABLE	TYPE	MEASUREMENT
1	Earnings management	Dependent	We measure Earnings management using accruals management which has also been used in measuring earnings management. Accruals management is derived using absolute value of discretionary as in modified Jones Model (1995).
2	Firm size	Independent	Total assets
3	Corporate governance	Independent	Board composition
4	Financial performance	Independent	Return on equity
5	Audit firm type	Independent	Big 4 and Non- Big 4

Source: Researchers compilation (2016)

5. PRESENTATION AND ANALYSIS OF RESULT

Table 1 Descriptive statistics

	DISACC	BDCOMP	AUDTYP	ROA	FSIZE
Mean	5.43E-11	0.30	0.642	9.208	7.358
Median	-44213.9	0	1	7.625	7.598
Maximum	835733.2	1	1	26.52	9
Minimum	-1040373	0	0	-4.9	1.4022
Std. Dev.	399546.9	0.466	0.481	8.341	1.298
Jarque-Bera	0.301	5.725	41.219	0.999	265.687
Probability	0.860	0.147	0.543	0.606	0.654
Observations	30	30	30	30	30

Researcher's Computation (2016).

Where: DISACC= Discretionary accruals, BDCOMP= Board composition, AUDTYP= Audit Firm type. ROA= Return on Assets. FSIZE= Firm size

From the descriptive statistics of the variables as shown in table 1 above, it is observed that DISACC as a mean value of 5.43E-11 with maximum and minimum values of 835733.2 and -1040373 respectively. The standard deviation measuring the spread of the distribution stood at 399546.9 which is large and suggest considerable dispersion in values for discretionary accruals from the

mean across the sample companies. BDCOMP s observed with a mean value of 0.30 indicating that 30% of the board members are independent members. The standard deviation value of 0.46 indicates average clustering around the mean. The mean for COMPANY SIZE stood at 7.358. The standard deviation of 1.298 shows evidence of clustering of firm size around the mean. The mean value for AUDTYP is 0.642 which suggest that about 64.2% of the companies use the services of the big 4 audit firms. Finally, the mean value for ROA stood at 9.208 with maximum and minimum values of 26.52 and -4.9 respectively. The standard deviation stood at 1.298. An evaluation of the Jarque-Bera statistics for the variables reveals that all the variables appears to be normal.

Table 2 Pearson Correlation result

	DISACC	*BDCOMP*	*AUDTYP*	*ROA*	*FSIZE*
DISACC	1				
BDCOMP	0.005.	1			
AUDTYP	0.001	0.068			
ROA	-0.003	0.008	0.006	1	
FSIZE	0.009	0.213	0.085	0.415	1

Researcher's Computation (2016).

Table 2 above presents the Pearson correlation coefficient result for the variables. As observed, DISACC and BDCOMP appear to be positively associated as depicted by the correlation coefficient (0.005). AUDTYP also shows positive correlation with DISACC (0.001) ROA is observed to be negatively correlated with DISACC (-0.003) and finally, SIZE is observed to be positively correlated with DISACC (0.009).The correlation coefficient results show that none of the variables are strongly correlated and this indicates that the problem of multicollinearity is unlikely and hence the variables are suitable for conducting regression analysis.

Table 3 Regression Result

Dependent Variable: DISACC				
Method: Least Squares				
Convergence achieved after 8 iterations				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	1.586	490547.7	0.3789	0.708
ROA	11.182	8036.908	1.3914	0.178
BDCOMP	-32.744	146902.1	-2.229	0.036*
SIZE	3.471	60999.68	0.569	0.575
AUDFTYP	-8.023	53582.95	-2.497	0.019*
AR(1)	-0.3133	0.199895	-1.567	0.131
R-squared	0.7557			
Adjusted R-squared	0.6023			

S.E. of regression	374897.5		
F-statistic	2.3190		
Prob(F-statistic)	0.0395		
Durbin-Watson stat	2.0159		

Diagnostic tests		
Heteroskedasticity	Serial correlation(LM test)	Ramsey reset test
f-statistic =1.646	f-statistic =0.6051	f-statistic = 1.568
Prob. F(6,672)=0.209	Prob. F(6,672)=0558	Prob. F(6,672)=0.136

Researcher's Computation (2016).

Table 3 above shows the ordinary least squares regression result conducted using Eviews 7.0. The white heteroskedasticity-consistent standard error is used to control for possible heteroskedasticity in the model while the auto-regressive scheme AR (1) term was included in the model for autocorrelation. As observed, the R^2 and coefficient of determination is 0.36 which indicates that the model explains about 75% of the systematic variations in the dependent variable. The F-stat value of 2.32 and the associated p-value of 0.039 do not provide a basis for rejecting the hypothesis of a joint statistical significance of the model in addition to the assumption of linearity of the model at 5% (p=0.20>0.05). The evaluation of the slope coefficients of the explanatory variables reveals the existence of positive though insignificant relationship between ROA and Discretionary accruals (DISACC) measure for earnings management at 5% (β_1=11.182, p=0.17>0.05). Freedman & Jaggi (1992) argues that the economic performance (measured by profitability) of firms can influence the level of reporting quality. Thus if management is performing badly financially, the tendency to want to manipulate the reporting process may be higher in order to impress shareholders and potential investors. **The estimates for ROA is however not significant and thus we reject H1.** The effect of Board composition on earnings management quality as measured by Discretionary accruals (DISACC) appears to be negative and significant at 5% (β_2=-32.744, p=0.036<0.05). The finding suggests that the nature of the board composition exerts a significant influence on the level of earnings management and that the existence of a higher number of external directors could be related to lower earnings management and hence higher reporting quality. The finding is consistent with Beasley (1996) which suggests that larger proportions of non-executive directors on boards tend to be negatively related to financial statement fraud. Sullivan (2000) and Carcello et al. (2002) document a positive relationship between the proportion of non-executive directors on a board and financial reporting quality. **The estimate for board composition is significant and thus we accept H2.**

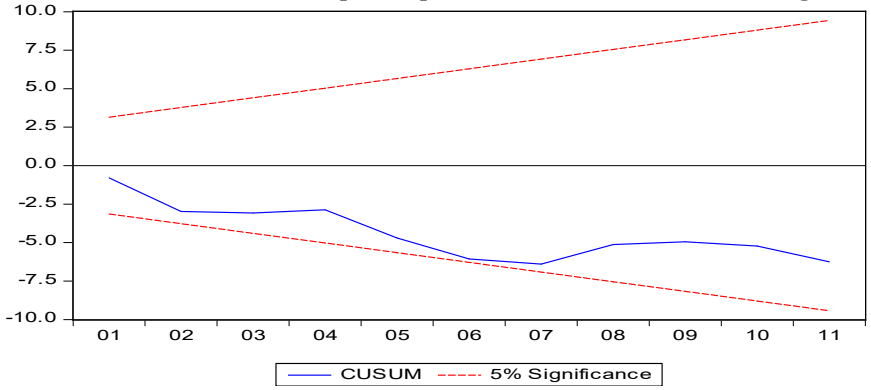
The effect of firm size on Discretionary accruals (DISACC) measure for earnings management appears to be positive though insignificant at 5% (β_3= 3.4718, p=0.575>0.05). The finding is consistent with previous research documenting a positive relation between firm size and disclosure policy decisions (Lang and Lundholdm, 1993). A positive association between size of a corporation and the extent earnings management has been consistently confirmed by prior studies (Stanny and Ely, 2008; Ho and Taylor, 2007). **The estimates for firm size is however not significant and thus we reject H3.** Finally, the effect of Auditor type on Discretionary accruals (DISACC) appears to be negative and also significant at 5% (β_3=8.0239, p=0.019<0.05). The finding is in line with Abdul Rahman and Ali (2006), Baxter and Cotter (2009) which indicate a significant association between

audit firm type and reporting quality. Also in line with the study finding is the work of Abbott et al. (2004). **The estimates for Auditor type is significant and thus we accept H4.**

The Durbin-Watson value of 2.01 indicates that stochastic dependence between successive units of the error term is unlikely in the model. The diagnostics tests for the regression results indicates the absence of in the model as the Breusch-pagan-Godfrey test was performed on the residuals as a precaution. The results showed probabilities in excess of 0.05, which leads us to reject the presence of heteroscedasticity in the residuals and hence we conclude that the assumption of uniform variance of the residuals is satisfied and the estimates are not biased. The LM test for high order autocorrelation shows that the likelihood of autocorrelation in the residuals is rejected and hence the regression estimates are not biased as the probabilities are greater than 0.05. The Ramsey RESET test was performed to determine whether there were specification errors. The results showed high probability values that were greater than 0.05, meaning that there was no significant evidence of miss-specification

Stability test

The CUSUM test (Brown, Durbin, and Evans, 1975) is based on the cumulative sum of the recursive residuals. This option plots the cumulative sum together with the 5% critical lines.



The test finds parameter instability if the cumulative sum goes outside the area between the two critical lines. As observed from the figure, the lines for the cumulative sum lie within the 5% critical lines and hence this suggests that the parameters of the model are stable.

6. CONCLUSION

The widespread failure in the financial disclosure has created the need to improve the financial information quality. Consequently, the factors influencing the occurrence of earnings management have been an intense and inconclusive area of research and an interesting issue of discourse. The factors have been identified to be both exogenous and endogenous to the firm. The exogenous factors have been highlighted to include the reporting standards and institutional environment, economic and financial policies and the board spectrum of variables outside of the firm's control. These factors have also not attracted considerable empirical research attention as controlling for the factors to make them amenable for empirical analysis is as a challenge especially in developing economies. The endogenous factors with the propensity to influence occurrence of earnings management have been identified also in the literature and these factors are generally regarded as being within the locus of control of the firm. Using the ordinary least squares

regression techniques, the study found the existence of negative significant relationship between board size, audit firm type and earnings management In addition, they study also found the existence of a non-significant relationship between firm size, ROA and earnings management. The recommendation is that there is the need for companies to consider the need to increase their board independence. Again companies must ensure that the auditors' they engage are credible and have a track record of delivering reports that show the actual state of affairs of a company. Companies and Allied Matters Acts should be regularly reviewed and updated so that stiffer penalty is metted out to those caught engaging in the act of earnings management.

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