

CORPORATE GOVERNANCE AND EARNINGS MANAGEMENT: EMPIRICAL EVIDENCE FROM MALAYSIAN AND NIGERIAN BANKS

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ABSTRACT

The objective of this study as a pioneer is to investigate the likelihood of virtually all key elements of corporate governance in reducing the scope of banks earnings management in both developed and emerging economies. The Modified Jones Model is explored to investigate earnings management. Investigations into the differences in key corporate governance structure including board independence, composition, size, frequency of board meeting, leadership independence, audit committee existence and size, audit committee chairman independence, frequency of audit committee meeting, separation of roles of chairman of board and CEO, auditors status, Basel II compliance were equally made. The sample of this study consists of all the listed Nigerian banks and Malaysian commercial banks for year 2007- 2011. For Nigerian banks the earnings management has a negative mean, which means that the total accrual was negative in the majority of the sample. On the other hand, total accruals have a positive mean for Malaysian sample banks. Consequently, the residual value in the equation (e_t) was higher for Nigerian banks compared to Malaysian banks, indicating respectively, lower/higher accruals and earnings quality. Key aspects of corporate governance have positive or negative association with earnings management. While these are mostly lacking in Nigerian banks' corporate governance structure, resulting in the poor accrual and earnings quality, high accruals and earnings quality of Malaysian banks is traceable to good corporate governance.

Keywords: corporate governance, earnings management, accruals, discretionary accruals, non-discretionary accruals, board leadership, composition, audit committee leadership

INTRODUCTION

Corporate governance becomes an important issue after the 1997 – 1998 monetary crises that hit several countries in Southeast Asia, including Indonesia. Several earnings management related international frauds and accounting scandals such as Enron, Worldcom and Parmalat in the United States and Kimia Farma and Bank Lippo in Indonesia to mention but a few, has fuelled public and government concern about the potency of corporate governance in ensuring that corporate reports communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information.

Financial reports are the most important output of an accounting system. The purpose of financial reporting is to provide the information which can be useful for business decisions (Schipper & Vincent, 2003). To Sloan (2001) the financial information is the first source of independent and true, communication about the performance of company managers. This relevance makes the financial reporting as the main attraction to management influence. The integrity of financial reporting is highly dependent on the performance and conduct of those

involved in the financial reporting ecosystems, particularly directors, management and auditors (Mohd, Rahman & Mahenthiran, 2008 and Yusoff, 2010). The most significant accounting item prepared and presented in financial reports is the—Earnings which is considered as a key factor in determining the dividend policy, a guideline for investment and decision making, a core measure of a firm's performance, an effective criterion in the stock pricing and eventually an instrument utilized to make predictions (Mohammady, 2012).

The issue of earnings usefulness is of major importance to the financial information users since earnings are widely believed to be the premier information items provided in financial statements (Lev, 1983). Focusing on decision usefulness, the quality of financial reporting is of interest to those who use financial reports for contracting purposes and for investment decision making. The chief interest in financial reporting is the earnings quality, which is part of the overall financial reporting quality. It plays a significant role in the usefulness of earnings in decision making process and is an important subject today because of the reliance of capital markets on credible financial reporting specifically income statement (Mohammady, 2012). Consequently, earnings management has received significant attention in the popular press and academic accounting literature (McNichols, 2000).

Though, arguments are mixed, prior studies evidence relationship between corporate governance and financial reporting quality, earnings manipulation, financial statement fraud, and weaker internal controls (Beasley, 1996; Beasley, Carcello & Hermanson, 1999; Beasley & Frigo, 2007; Carcello & Neal, 2000; Dechow, Sloan & Sweeney, 1996; Klein, 2002; McMullen & Raghunandan, 1996 and Norwani, Mohammed & Ibrahim, 2011). While Cornetta, McNuttb, & Tehranianc (2009); Qiao, & Zhou (2007); Findlay (2006), Davidson, Goodwin-Stewart, & Kent (2005); and Xiea, Davidson, & DaDaltb (2003) respectively using sample of firms from U.S., China, New Zealand, Australia, argued that corporate governance may be important factor in constraining the propensity of managers to engage in earnings management, Hashim & Devi (2008), Agrawal & Chadha, (2005) and Klein (2002) respectively focusing on Malaysia, and U.S public companies find that several key governance characteristics are unrelated to the probability of a company restating earnings.

In addition, most of these studies focus more on developed economies. Andrea, Lotte & Chloe (2012) affirmed that there are major differences between governance practices and disclosure standards in developed and emerging markets. Governance models in many emerging economies greatly differ from common practice in developed markets. This is also an important gap in this literature given the underlying premise of this study, that there exist substantial differences in the institutional, organisational and market infrastructures of emerging and developed markets. More so, while prior studies that investigate the impact of corporate governance on earnings quality focus on multi-industry manufacturing firms, this study is one of the limited studies that focus on specific industry sample-banking sector. Finally, while previous studies sherry picks limited governance characteristics, this study attempt to capture as many key governance characteristics that are related to the probability of a firm restating earnings.

It is against this backdrop and in addition to the fact that the 2008 financial crisis transformed into a grim reality the academic assertion that a healthier economy cannot exist without a well-functioning financial system (Mehran & Mollineaux, 2012), that this study choose as an objective to provide a comparative empirical analysis of the respective implications of corporate governance practices of Malaysian and Nigerian banks on the quality of their earnings.

This study is divided into five sections. Section one is the introduction. Section two discusses conceptual framework on corporate governance, earnings management, Malaysia

and Nigeria country profiles and the justification for the banking sector as case study. Section three focuses on the development of model and variable definitions. Section four is centred on data presentation, analysis and interpretation of results while section five is all about conclusions and possible recommendations.

CONCEPTUAL FRAMEWORK

Corporate Governance

Good corporate governance (GCG) in a corporate set up leads to maximize the value of the shareholders legally, ethically and on a sustainable basis, while ensuring equity and transparency to every stakeholder – the company's customers, employees, investors, vendor-partners, the government of the land and the community (Millstein, 2002; Murthy, 2006;). Corporate governance is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. Thus it ensures the conformance of corporations with the interests of investors and society, by creating fairness, transparency and accountability in business activities among employees, management and the board (Kar, 2012; Shil, 2008; Oman, 2001). Prior studies evidence association between weaknesses in governance and poor financial reporting quality, earnings manipulation, financial statement fraud, and weaker internal controls (Beasley, 1996; Beasley, Carcello & Hermanson, 1999; Beasley & Frigo, 2007; Carcello & Neal 2000; Dechow, Sloan & Sweeney, 1996; Klein, 2002; McMullen & Raghunandan, 1996 and Norwani, Mohammed & Ibrahim, 2011) and that when key elements of corporate governance are not implemented, there will be negative consequences on financial reporting quality because it plays important roles in the process of improving the financial reporting quality as well as to prevent earnings manipulation and fraud (Cohen, Wright & Krishnamoorthy, 2004).

For example, Beasley (1996) argued that the probability of detecting financial statement fraud in the American firms decreases with the percentage of outside directors. Firth, Fung & Rui (2007); Beekes, Pope & young (2004); Peasnell, Pope & Young (2000); Klein (2002); Dechow et al. (1996); Norwani et al. (2011); and Beasley et al. (1996) evidence that the presence and number of independent directors is positively associated with earnings quality. Dimitropoulos & Asteriou (2010); Bushman, Chen, Engel & Smith (2004); Vafeas (2005) and Karamanou & Vafeas (2005) show that the information quality increases with the percentage of outside directors. Vafeas (2000); Ahmed, Hossain & Adams (2006); Bradbury, Mak & Tan (2006) and Jensen (1993) found that large board size reduces the information content of incomes and intensifies the earnings management respectively for American, Singapore and New Zealand firms.

Similarly, the appointment of an independent external auditor and audit committee can reduce the probability of earnings manipulation (DeAngelo, 1981; Becker, DeFond, Jiambalvo & Subramanyam, 1998; Chung, Firth & Kim, 2003; Antti & Jari, 2012; Dechow, et al., 1996; DeFond & Jiambalvo, 1991; Brown, Falaschetti & Orlando, 2010; Teoh & Wong, 1993). Finally, theoretical and empirical studies about corporate governance have suggested that the ownership structure can affect the financial reporting quality (Fan & Wong, 2002; Jiambalvo, Rajgopal & Venkatachalam, 2002; Klein, 2002; De Bos & Donker, 2004; Klai & Omri, 2011; Han, 2005; Karamanou & Vafeas, 2005; Wang, 2006; Beekes et al., 2004; Yeo, Tan & Chen, 2002; Demsetz & Lehn, 1985; Shleifer & Vishny, 1986).

Earnings Management

Earnings management has attracted the attention of academic researchers in accounting and finance, especially in recent years after many accounting scandals in prominent companies

such as Enron and WorldCom1 (Ibrahim, 2005; Giroux, 2004 and Faouzi & Mohamed, 2012). Equally, the issue of earnings management has always been a concern for the integrity of published accounting reports. Evidence from the academic literature has shown that the practice of earnings management is extensively practiced by publicly listed firms (Zhou et al., 2009; Barth et al., 2005; Burgstahler & Dichev, 1997). Beatty & Harris (1999) and Beatty et al. (2002) present evidence from the banking industry suggesting that public banks engage in more earnings management than their private counterparts.

Consistent with Healy and Wahlen (1999); DeGeorge, Patel & Zechhauser, (1999); Ronen & yaari (2008); Hamidreza, Davood & Elmira (2012); Leuz et al. (2003) and Ghosh, (2010) earnings management is a mechanism used by managers of companies to intentionally alter 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 with the view to systematically misrepresent the true income and assets with the view to mislead some stakeholders or to influence contractual outcomes. Fauzi & Mohammed (2012); Beatty et al. (2002); Burgstahler, Hail & Leuz (2004); DeGeorge et al. (1999) and Sherry, McDowell and Erin (2010) posit that firms manage reported earnings for three major purposes, namely, to avoid losses, to avoid earnings decreases, and to meet analysts' earnings expectations.

Arguments are on-going on whether earnings smoothing is fraudulent or not. While Molenaar (2010) and Stolowy & Breton (2004) considered earnings management to be fraudulent, Tianran (2011) and Brooks (1998) argued that it is a reasonable and legal management decision making and reporting, intended to achieve and disclose stable and predictable financial results. Therefore even when manipulation of financial numbers by managers are within the letter of the law and accounting standards, they are very much against the spirit of these rules, objectives of financial reporting and International Financial Reporting Board, the principles of corporate governance and certainly not providing the "true and fair" view of a company's results and financial position.

Justification for Banks as Case Study

The Banking Sector has for centuries now formed one of the pillars of economic prosperity, local or foreign. It is one of the important financial pillars of the financial system which plays a vital role in the successful/failure of any economy. The sector is the lifeline of any modern economy (Aziz, 2012; Sharma & Sharma, 2009). The banking sector plays an important role as financial intermediary and is a primary source of financing for the domestic economy and hence, one of the oldest financial intermediaries in the financial system (Sharma and Sharma, 2009; Hanid, Zarkaria, Abd Karim, Abd Wahab, Stabal & Lee, 2007). To Kamau (2011) in any economy, the financial sector is the engine that drives economic growth through efficient allocation of resources to productive units. The legislated function of banks essentially implies a stable and efficient financial system that underpins intermediation process for economic growth and development. A pointer to this is the failure of banks' lending to firms and households to pick up in Europe and the UK since 2010 suggests that the financial system is still unable to support the economy (Blundell-Wignall, & Atkinson, 2012). They play an important role in the mobilization of deposits and disbursement of credit to various sectors of the economy. Through this function, banks facilitate capital formation, lubricate the production engine turbines and promote economic growth.

Thus the strength of the economy of any country basically hinges on the strength and efficiency of the financial system which, in turn depends on a sound and solvent banking system (Sharma & Sharma, 2009). Therefore, it is uncontroversial that the banking system is the engine of growth in any economy, given its function of financial intermediation (Adeyemi, 2012 and Sanusi, 2011). Banking sector efficiency is important for promoting

access to financial services as well as stability of the banking sector as integral component of the financial system. Banks play essential role in the proper functioning of payments systems and their efficiency is directly related to improved productivity in the economy (Ikhide, 2008).

However, banks' ability to engender micro or global economic growth and development depends on the health, soundness and stability of the sector. In order to fulfil all those functions, the banking sector needs to be trustworthy and transparent (Sala-I-Martin et al., 2013). Thus, proper functioning, through adequate supervision and governance of the financial sector-banking, sector-hinges on adequate transparency and accountability being built into reporting practices in the corresponding sub-sectors. In this regard, financial sector vulnerabilities pose great challenges for the conduct of monetary policy (Draghi, 2012). Contrary, prior literatures have documented that business firms' managers, including banks managers, manage their reported earnings for many different purposes (Wahlen, 1994; Collins, Schackelford & Wahlen, 1995; Kanagaretman, Mathieu & Lobo, 2003; Kanagaretman, Lobo, & Yang, 2004; Liu & Ryan, 2006). It is against this background, including the continuous exclusion of the financial industry – banks from samples of studies that use discretionary accrual estimation models to investigate earnings management, that this study acquire banking sectors in Malaysia and Nigeria, as representatives of developed and emerging economies to provide a comparative analysis of the impact of their respective banks' corporate governance structures, principles and practices on the quality of their earnings.

Malaysia and Nigeria Country Profiles

Malaysia covers an area of 329,847 km² (67th) (127,355 sq mi). Malaysia border countries include: Brunei 381 km, Indonesia 1,782 km, Thailand 506 km. Going by the 2010 census, Malaysia has a population of 28,334,135 of which 72% of total population constitutes the urban population. On the other hand, Nigeria covers an area of 923,768sq km (356,669sq mile). It is bounded by Cameroon to the east, Chad to the northeast, Niger to the north, Benin to the west, and Gulf of Guinea on the Atlantic Ocean to the south (Ofem, 2012). Going by the most recent national census held in 2006, Nigeria has a population of over 140 million inhabitants out of which about 48% live in urban centres. While Malaysia is one of the developed countries of the world, Nigeria is one of the emerging economies. There are some fundamental differences between developed and emerging countries as mentioned by Hofstede and Hofstede (2004) that emerging markets are substantially different from developed markets in terms of the institutional, organisational and market aspects of the economy and society.

Emerging markets have a weaker and less mature capital market with financial systems dominated by banks. Policies adopted toward the banking systems in these countries often severely constrain the behaviour of banks, in a policy syndrome referred to as financial repression. In many other cases, the banking systems are dominated by government banks (Gibson, 2003; Lins, 2003). Supervisory and regulatory authorities are dependent on political interference in the daily execution of supervisory tasks thereby limiting the roles taken by regulatory authorities (Berghe, 2002). Ownership by state governments is also common in many emerging market countries (Claessens, Djankov & Lang, 2000; Shleifer & Vishny, 1997; Thillainathan, 1998) which leads to greater information asymmetry. In addition, accounting standards in developing markets are typically different from those of developed markets, which make it harder for investors to judge the true performance of a firm in an emerging financial market and thus make rational investment decision (Rashid & Islam, 2008).

METHODOLOGY AND MODEL BUILDING

Models

To investigate earnings management, this study first estimate total accruals and subsequently modifies and employs the Jones model to investigate discretionary accruals. Consistent with Dabor & Adeyemi (2009); Daniel & Paul (2000); Collins & Hribar, (2002); William (2004); Keefe (2012); Ilanit (2007) and Dechow & Ge, (2006) this study estimate Total Accruals (TA) using details from cash flow statements and income statements of banks.

$$TA_{jt} = PBTE_{jt} - OCF_{jt} \dots\dots\dots (i)$$

Where

TA_{jt} = Total Accruals of bank j at time t

PBTE_{jt} = Profit before tax and extraordinary items for bank j at time t; and

OCF_{jt}= Operating cash flows taken directly from cash flow statement for bank j at time t.

Jones Model

Clearly, measures of earnings management based on the Jones (1991) model need to be modified for banks or other financial institutions that are not engaged in sales-based businesses (Cohen, et al., 2011). Thus, given consideration to the standard Jones (1991) model and modifications by Dechow, Sloan & Sweeny (1995); Guay, et al. (1996); Cahan (1992) this study modify the Jones model by introducing gross earnings (GE) to replace SALE/REV. This is because what sales or revenue is on the financial statement of manufacturing firms are gross earnings to banks. Banks total gross earnings is the sum of interest and similar income, fee and commission income, foreign exchange income, trusteeship income, income from investments and other income. In addition, what goods are to manufacturing industry are loans to banking sector. While manufacturing firms sell goods, banks sell loans. Therefore there is every possibility for loans to go bad. Thus, to estimate these variables, the following formula applies:

$$\text{Gross Earnings (GE) = Interest Income (IINC) + Fee Commissions (FCOM) + Foreign Exchange Income (FOREXINC) + Trusteeship Income (TINC) + Investments Income (INVINC) + Sharia Income (SHINC) + Other Income (OINC) \dots\dots\dots (ii)}$$

$$\text{Total Loans (TL) - Non-performing Loans (NPL) = Net Loans (NL) \dots\dots\dots (iii)}$$

Thus, consistent with Dechow et al. (1995), Net Loan (ΔNL) is introduced to replace ΔREC.

The modified Jones model is given as follows:

$$DAC_{jt} = TA_{jt}/AST_{jt-1} - [a_0 (1/AST_{jt-1}) + a_{1, i} (\Delta GE_{jt}/AST_{jt-1} - \Delta NL_{jt}/AST_{jt-1}) + a_{2, i} (PPE_{jt}/AST_{jt-1}) + e_{jt} \dots\dots\dots (iv)}$$

Where

TA_{jt} is total accruals of bank i calculated as the difference between profit or loss before taxation, exceptional and extraordinary items and operating cash flows for year t;

AST_{jt-1} is assets at the beginning of the year;

ΔGE_{it} is the change in Gross earnings from year t-1 to t);

ΔNL_{jt} is the change in the analysis of total loans and advances and non-performing loan from year t-1 to t to reflect change in Net Loans (ΔNL) replacing change in Receivables (ΔREC); and PPE is gross property, plant, and equipment.

e_{jt} is the error term or residual indicating discretionary accruals.

The introduction of Gross Earnings (GE), Loans and nonperforming loans to reflect net loans is to enable the model investigate discretionary accruals accurately as managers have discretions over accruals accounts and transactions like loans, nonperforming loans, and loan loss provision (Gebhardt & Novotny-Farkas, 2010; Samadi & Valahzaghari, 2013; Marton & Runesson, 2012; Tianran, 2011 and Rolland, 2012).

All variables are deflated by prior year's total assets to reduce the problem of heteroscedasticity consistent with prior studies (Rashidah & Afidah, 2002).

Study Sample and Period

The sample of this study constitutes banks listed on the Nigerian Stock Exchange Commission and Malaysian Local Commercial banks 2007 to 2011. This study used details of total accruals (TA) obtained by subtracting operating cash flows (OCF) from profit before tax and extra ordinary items (PBTE), gross earnings (GE), total assets (TA), loans and advances, property, plant and equipment (PPE), non-performing loans to investigate earnings management for the period of study using the modified Jones model. Corporate governance details were directly captured equally from the annual reports of these banks.

Analysis and Interpretation of Data

Sequel to the fact that this study provides a comparative study of the Malaysian and Nigerian situations in terms of the relationship between key corporate governance mechanism and earnings management in the banking sector, it is worthy to note that the findings of this study indicate opposite results in terms of variables values, practical situations and practices of corporate governance for both samples affirming the fundamental dichotomies in their economies and the reasons for the differences in their earnings quality. These findings are discussed in the following section.

Earnings Management

Consistent with Jones (1991); Yasuda, Shin'ya & Masaru (2004) and Shubita & Shubita (2010) for Nigerian banks the earnings management has a negative mean. This means that the total accrual with a mean of -0.04919 was negative in the majority of the sample. This happened because the average operating cash flow was more than the average net income, which is normal because much expenditure have been deducted from income and have not been included in the operating cash flow such as depreciation and amortization. On the hand, following Dechow, Hutton, Kim, & Sloan (2011) the earnings management for Malaysian banks has a positive mean resulting from the fact that the total accrual with a mean of 0.003795 was positive in the majority of the sample. With total accruals of Malaysian banks having a positive mean, it suggests that the Malaysian sample banks have grown in scale. With this situation, results equally show that Malaysian banks investment in property, plant and equipment is significantly low compared to Nigerian banks

Earnings Quality: Residual Analysis Approach

The absolute value of abnormal accruals ($|AA_{jt}|$) is the measure of earnings quality with lower values indicating higher earnings quality. A common measure of earnings management in industrial firms is based on discretionary accruals from the modified Jones (1991) model (Dechow, et al., 1995). Specifically, "normal" accruals were estimated from a simple statistical model based on firm assets, property, plant and equipment, and change in gross earnings (GE) and net loans (NL). "Abnormal" or discretionary accruals are the residuals between actual accruals and the predicted accruals from the modified Jones model.

Residual statistics and analysis of variance are provided in table 1, 2 and 3. The high residual value in the equation (e_i) for Nigerian banks is 1.94782 which means that there exist a weak relationship between the independent and dependent variables evidencing poor quality of accruals and high level of earnings management in the Nigerian banking sector. The higher the value of (e_i), the weaker the relationship between total accruals (TACC), gross earnings (GE), net loans (NL) and property, plant and equipment (PPE). On the other hand, the residual for Malaysian banks is 0.075062 evidencing a stronger association between these variables, thereby indicating high accrual quality and minimal scope of earnings management for Malaysian banks. In addition, Nigerian banks have -0.97546 and 0.49718 representing respectively minimum and maximum residuals and with a median of 0.03385. Conversely, Malaysian banks exhibit respectively minimum and maximum residual values of -0.132780 and 0.082327, having a median of 0.004758.

Table 1. Residuals Statistics

	<i>Min</i>	<i>IQ</i>	<i>Median</i>	<i>3Q</i>	<i>Max</i>
Malaysian Banks	-0.132780	-0.031928	0.004758	0.034110	0.082327
Nigerian Banks	-0.97546	-0.05150	0.03385	0.07218	0.49718

Table 2. Analysis of Variance Table for Nigerian Banks

	<i>Df</i>	<i>Sum Sq</i>	<i>Mean Sq</i>	<i>F value</i>	<i>Pr(>F)</i>
X1	1	0.01198	0.011976	0.3136	0.577949
X2	1	0.00443	0.004427	0.1159	0.734914
X3	1	0.27513	0.275129	7.2037	0.009787
Residuals	51	1.94782	0.038193		

Signif codes: 0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1

Table 3. Analysis of Variance Table for Malaysian Banks

	<i>Df</i>	<i>Sum Sq</i>	<i>Mean Sq</i>	<i>F value</i>	<i>Pr(>F)</i>
X1	1	0.000234	0.00023363	0.0871	0.7700
X2	1	0.001162	0.00116155	0.4333	0.5158
X3	1	0.000351	0.00035121	0.1310	0.7201
Residuals	28	0.075062	0.00268077		

Signif codes: 0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1

CORPORATE GOVERNANCE FEATURES AND PRACTICES

Board

Prior studies suggest that there exists significant association between several boards characteristics and earnings management. Hashim & Devi (2008); Abdul & Mohammed (2006) and Xiea et al. (2003) respectively studied the association between board

independence, board size and number of meetings, frequency of board meetings and earnings quality. Consistently, this study examine board characteristics in terms of board composition, board independence, board size, frequency of board meetings, board chairman's status and number of board committees. For both Malaysian and Nigerian banks, there exist basically two types of board directors: executive and non-executive Directors. The latter is further classified as independent non-executive and non-independent non-executive directors. Table 4 provides summary statistics of board characteristics of Malaysian and Nigerian banks.

Table 4. Summary Statistics of Board Characteristics of Malaysian and Nigerian Banks

<i>Board characteristics/Country</i>	<i>Malaysian Banks</i>	<i>Nigerian Banks</i>
Board Size (Average)	10.25 members	14.15 members
Non-Executive Directors	88%	60.9%
Executive Directors	12%	39.1%
Independent Non-Executive Directors	63.89%	18.52%
Non-Independent Non-Executive Directors	36.11%	81.48%
Board meetings	13.38 times	7.46 times
Non-Independent Non-Executive Board Chairman	87.5%	92.31%
Independent Non-Executive Board Chairman	12.5%	7.69%
Number of Board Committees (Average)	4.875	4.62

Source: Developed for this study

This study define Board composition as a percentage of either executive or non-executive directors to total board members and conjecture that the higher the percentage of non-executive directors, the lower the domineering and control of board by management. Abdul and Mohammed, 2006 affirmed that based on the managerial hegemony theory, the capability of independent directors to fulfil their monitoring role is jeopardized when the management also dominates and controls the board. While Malaysians banks have averagely, 10.25 board members, Nigerian banks have averagely 14.15 total board members. Of these, 88% of directors of Malaysian banks are non-executive while the remaining 12% are executive directors. This is contrary to the Nigerian situation where, 60.9% are non-executive and 39.1% represents management.

This study defines board independence as the percentage of either independent non-executive or non-independent non-executive directors to total non-executive directors. 63.89% of the total non-executive directors of banks in Malaysian banks are independent non-executive directors while the remaining 36.11% are non-independent non-executive directors. Conversely, about 50% of Nigerian banks neither have independent non-executive directors, nor provide information about their existence. Some claim there is a blend between independent non-executive directors and non-independent non-executive directors in the composition of the non-executive directors. Of the remaining 50%, 18.52% of the non-executive directors are independent while the remaining 81.48% are non-independent non-executive directors. This distinction is pertinent because, consistent with Hashim & Devi (2008) non-independent non-executive directors are sometimes a family member, who may

not have the expertise skills and knowledge in financial reporting (Abdul & Mohamed, 2006). Firth, Fung & Rui (2007); Beekes, Pope & Young (2004); Peasnell, Pope & Young (2000) and Klein (2002) in their study of United Kingdom and Chinese firms revealed that the independent board mitigates earnings management. That is the presence of independent directors improves the earnings quality as board independence allows disclosing information of good quality by the firms. Fraud is also more likely in firms that have fewer independent members of the board and audit committee (Dechow, et al., 1996; Beasley, 1996).

Board size is defined here as the total number of board members. Roughly banks in Nigeria have the highest number of board size compared to Malaysian banks. As stated earlier, Nigerian banks have averagely 14.15 total board members, while Malaysians banks have averagely, 10.25 board members. A bank in Nigeria has 14 total board members, another 15, set of two each, 16 and 17 respectively, yet another 19. The maximum total number of board members for Malaysian banks is 12 while the minimum is 8. About 38% of Malaysian banks have total board members of 12, another 38% 10 and the remaining 24% 8 members. Vafeas (2000); Ahmed, Hossain & Adams (2006); Bradbury, Mak & Tan (2006) and Jensen (1993) found that large board size reduces the information content of incomes and intensifies the earnings management respectively for American, Singapore and New Zealand firms. Abdul & Mohamed (2006) argue that coordinating and processing problems becomes more difficult when the boards are too large. This makes larger boards more ineffective in performing monitoring functions (Hashim & Devi, 2008). Consistently, this study discovers that a reduced number of directors imply a high degree of coordination and communication between them and the managers.

Board meeting is defined here as the frequency of board meetings in a year. This clarification is necessary because Xiea et al. (2003) argue that boards that meet more often could reduce earnings management activity as they are able to allocate more time on issues such as earnings management while boards that seldom meet are unlikely to focus on these issues. They found evidence of a negative association between a lower level of earnings management and the meeting frequency of the board and suggest that board activity provides effective monitoring mechanisms of corporate financial reporting. This study reveals that Malaysian banks board of directors meets twice as many times Nigerian banks boards meet. Boards of banks in Malaysia meet as high as 13.38 times averagely in a year. 25% of boards of Malaysian banks meet 9 times per annum, another 25% 10 times. The remaining 50% divided equally into 12.5% each respectively meet for 14, 16, 17 and 22 times per year. Conversely, the average meeting times for boards of Nigerian banks is 7.46 times per annum. 23% of the banks boards meet 5 times or less in a year, 54% 8 times or below while the remaining 23% meet 10 times including just a bank that has the highest meetings of 12 meetings in a year.

Board chairman's status is defined in terms of his status as independent non-executive director or non-independent non-executive director. Given the fact that the presence of independent directors improves the earnings quality as board independence allows disclosing information of good quality by the firms (Peasnell, Pope & Young, 2000 and Klein, 2002), and the likelihood that some non-independent non-executive directors are sometimes family members who may not be knowledgeable in corporate governance and financial reporting, the independence of the chairman of board becomes a grim reality. This study shows that 87.5% of board chairmen of banks Malaysia are non-independent non-executive while 12.5% are independent non-executive. Contrary, 92.31% of board chairmen of Nigerian banks are non-independent non-executive directors while the remaining 7.69% are independent non-executive directors. Considering both countries, the variation is not significant.

Finally, board committee is defined as the number of committees boards of sample banks establish for the reporting year. Xiea et al. (2003) using a sample of 281 firms from 1992, 1994, and 1996 examine the role of the executive committee in preventing earnings management and conclude that executive committee activity and their members' financial sophistication may be important factors in constraining the propensity of managers to engage in earnings management. Averagely board of Malaysian banks operate through 4.875 committees, with 37.5% of the banks having 4 committees, yet another 37.5% 5 committees and the remaining 25% having 6 committees. However, board of Nigerian banks operate averagely using 4.62 different committees, with 7.69% of the banks having 3 committees, 46.15% having 4 committees, while the remaining 53.84% divided equally into 26.92% respectively used 5 and 6 committees. This result indicates insignificant variation comparing both countries.

Audit Committee

Prior studies show that firms without audit committee are more likely to have financial statement fraud (Dechow, et al., 1996, Jeanjean, 2000, Davidson, Goodwin-Stewart, & Kent, 2005, Xiea et al., 2003, Klein, 2002) and earnings overstatement (DeFond & Jambalvo, 1991). Unlike prior studies, this study focus on some critical but specific features of audit committee including the existence of board or shareholders audit committees, independent non-executive or shareholder audit committee chairman, its frequency of meetings and size. The plausible explanation for this delimitation is that the roles of overseeing financial reporting process have been delegated to the audit committee, since 1993 (Abdullah & Mohd Nasir, 2004).

Table 5. Statistics of Features of Audit Committees of Malaysian and Nigerian Banks

<i>Audit Committee Features\Country</i>	<i>Malaysian Banks</i>	<i>Nigerian Banks</i>
Existence of Board Audit Committee	100%	23.07%
Existence of Shareholders Audit Committee	-	76.93
Independent Non Executive Audit Committee Chairman	100%	23.07%
Shareholder Audit Committee Chairman	-	76.93%
Audit Committee Meetings (Average)	12.88 times	4.46 times
Audit Committee Size (Average)	4.75	5.85

Source: Developed for this study

Malaysian banks boards of directors have operational board audit committees. 100% of these audit committees have as chairmen, independent non-executive directors. Cornetta, McNuttb & Tehranianc, (2009) using a sample of the 100 largest BHCs measured by 1993 year-end total assets showed that board independence is negatively related to earnings management. On the other hand, 76.93% audit committees of banks in Nigeria are established by shareholders during annual general meeting and consequently the leadership and most members of such audit committees are shareholders. 23.07% of Nigerian banks have board audit committees attracting leadership as non-executive directors. This is a major concern and setback for Nigerian banks because majority of these shareholders appointed as chairman of audit committees may not exhibit rigorous enquiry and intellectual challenge including the demonstration of excellent in-depth knowledge and understanding of financial reporting that

the board and audit committee has come to expect. This is due to the fact that these shareholders perhaps are appointed because of the magnitude of shareholdings, sometimes a family member and lack of the rigorous but fundamental selection process criteria for non-executive.

Audit committee meeting is defined here as the frequency of audit committee meetings in a year. To be specific, following Xie et al. (2003) audit committees that have members with adequate expertise and skills to understand financial reporting details and meet more often could reduce earnings management activity as they are able to allocate more time on issues such as earnings management while audit committee that seldom meet are unlikely to focus on these issues. This study reveals that Malaysian banks audit committees meet about three times Nigerian banks audit committee meetings. Audit Committees of banks in Malaysia meet as high as 12.88 times averagely in a year. 75% of audit committees of Malaysian banks divided equally into 12.5% each respectively meet 7, 8, 10, 12, 13 and 21 times per year. The remaining 25% meet 16 times per year. Conversely, the average meeting times for audit committees of Nigerian banks is 4.46 times per annum, with 7 and 4 respectively as the highest and lowest meeting times for the year. Audit committee size is defined here as the total number of members of audit committee. Roughly banks in Nigeria have the highest number of audit committee size compared to their counterparts in Malaysia. While Nigerian banks have averagely 5.85 total members of audit committee, Malaysians banks have averagely, 4.75 audit committee members.

CEO Duality

The MCCG 2000 also recommends a separation of roles between the chairman and the CEO to avoid the considerable concentration of power where the same person performs both roles. With the separation between the position of the CEO and the chairman it is hoped to provide an essential check and balance over the management's performance (Hashim & Devi, 2008). Furthermore, the Cadbury Report recommends that all listed companies should have no role duality to ensure a balance of power and authority leading to more independent boards (Ow-Yong & Guan, 2000). This study measures separation of roles between the chairman and the CEO by investigating whether the chairman of board is either an executive director or non-executive director. Deeper still, consideration is given to whether the chairman is an independent non-executive or non-independent non-executive director. This study reveal that though no executive director chairman's any board for both samples, the degree of separation still vary as majority of the board chairmen of Nigeria banks are non-independent non-executive directors while board chairmen of Malaysian banks are independent non-executive directors.

Auditors Status

Brown, Falaschetti & Orlando (2010) posit that external auditor independence is high for BIG 4 audit firm and consequently, (Teoh & Wong, 1993; Becker et al., 1998) advocate that the financial information is more reliable for BIG 4 clients in comparison with other companies. Consistently, this study discovers that there is no significant difference between the status of auditors for both Malaysian and Nigerian banks.

Basel II

Basel II is the second of the Basel Accords, (now extended and effectively superseded by Basel III), which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision. Fundamentally, while no bank in Nigeria adopt Basel II as global standards, all banks in Malaysian adopted Basel II in line with the directive from

Bank Negara Malaysia ('BNM'). The Basel II framework is structured around three fundamental Pillars.

- I. Pillar 1 defines the minimum capital requirement to ensure that financial institutions hold sufficient capital to cover their exposure to credit, market and operational risks.
- II. Pillar 2 requires financial institutions to have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.
- III. Pillar 3 requires financial institutions to establish and implement an appropriate disclosure policy that promotes transparency regarding their risk management practices and capital adequacy positions.

CONCLUSIONS AND RECOMMENDATIONS

The modified Jones model was able to investigate earnings management of banks in Malaysian and Nigeria. The residuals of the model indicating accruals and earnings quality was higher for Nigerian banks than Malaysian banks. Thus Nigerian banks are more likely to frequently and significantly manage their earnings compare to Malaysian banks. There are significant and material differences in the structure and practices of corporate governance in the banking sectors of the two economies. While the corporate governance of Malaysian banks could be described 'good', comparatively, Nigerian banks corporate governance may be judged 'poor'.

Therefore, this study, consistent with previous studies conjecture and conclude that the poor corporate governance structure and practices of Nigerian banks allows for the higher frequency and wider scope of earnings manipulation while the good corporate governance principles, structures and practices associated with Malaysian banks are fundamental factors that forestall and limit the extent and degree of earnings management. It is therefore recommended that Nigerian banks should borrow leaf from the operational corporate governance practices of Malaysian banks, particularly as it regards compliance with Basel II requirements, ensuring higher number of executive directors on the board and the composition, leadership and meeting frequencies of both board of directors and audit committee.

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