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THE INTERVENING ROLE OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ON CORPORATE GOVERNANCE AND INCOME SMOOTHING IN NIGERIA

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Abstract: **Income smoothing as an accounting practices is an earnings management strategy that has continued to attract the attention of Company Board of Directors, the accounting profession and accounting research in recent times. Income smoothing entails the use of financial reporting principles and standards in smoothening fluctuations in earnings. It a theoretical investigate of intervening role of International Financial Reporting Standard on corporate governance and income smoothing. This study conceptually examine specifically the relationship between board size in relation to income smoothing over the intervening role of International Financial Reporting Standard (IFRS). It is a library type of research by way of conceptual review of extant studies. It employed secondary source of information and were obtained from textbooks, journal articles, seminar papers and the internet. Following the outcomes of various studies reviewed, the study found that much divergence and inconsistent in result such that corporate governance either positive or negative relationship with income smoothing.**

Keywords: **Corporate governance, Income smoothing, Board size.**

1. INTRODUCTION

Income smoothing is a growing issue of concern, threatening the credibility of both the accounting and auditing functions. Guillaume and Pierre (2016) stated that manipulating incomes reduces the important aspects of financial reports and more so the accounting principles. The need to control the wide-spread act of income smoothing and ensure transparency and credibility of corporate reports necessitated corporate governance and adoption of international financial reporting standards (IFRS) around the world(Guillaume & Pierre, 2016). Corporate governance provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined (Omoye & Eriki, 2014). Instituting good corporate governance practices and adoption of international financial reporting standards (IFRS) are aimed at promoting transparency, accountability and integrity of financial report and accounts of companies with the intent of reducing income smoothing as a form of earnings management(Samak, El Said, & El Latif, 2014; Saftiana, Mukhtaruddin & Ferina, 2017).

Agency theory has provided the theoretical foundations for expectations about how corporate governance can at least help to reduce if not eradicate the tendencies of income smoothing. Although, income smoothing can be a legal approach, it is deceptive because it capitalizes on the loopholes in the accounting standards and principles to manipulate income by

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increase or decrease as the case maybe. Al-Baaj, Al-Zabari and Abbas. (2018) noted that income smoothing entails changing of expenses and revenue for the purpose of presenting deceitful imprint that a firm has stable earnings. When businesses do income smoothing, there is no correct information to determine their actual earnings (Moh & Winny, 2014). There are bound to be agency problem and information asymmetry arising from income smoothing activities by management of firms for personal gains (Mohammad & Ehsan, 2011).

In Nigeria, several attempts have been made at the institutional level to ensure that corporate governance is effective and results in improved financial reporting through declining income smoothing. This has culminated into the "Nigeria code of corporate governance" issued in November 2003 and the new code in 2016 provides further insight into the relationship between income smoothing and corporate governance in the Nigerian environment. Countries all around the world are putting together corporate governance best practices guidelines to stimulate credible financial reporting. Some examples are; Cadbury Report was produced in the United Kingdom of 1992, Sarbanes Oxley in United States of 2002, The Dey Report in Canada of 1992, the Vienot Report in France of 1995, the Olivencia Report in Spain of 1998, the King‟s Report in South Africa in 1994, Principles and Guidelines of Corporate Governance in New Zealand of 2004 and the Cromme Code in Germany of 2002. The goal of most of these regulations is to improve firms' corporate governance environments and enhance basic objective of financial reporting for economic decisions (Bhagat & Bolton, 2009).

Corporate managers may be motivated to smooth income for their own interest. While the problem of income smoothing cannot be regarded as new, it continues to be a key issue in accounting research because of the misrepresentation of financial reports that result from the practice. Importantly, this study introduces the intervening role of IFRS adoption in the relationship between corporate governance and income smoothing to present a more robust insight of the inter-play of processes that affect income smoothing behavior of managers. The adoption of IFRS has been credited with more transparent information environment, accounting quality and reduction in managerial opportunism. Hence, this study conceptually investigates corporate governance on income smoothing by considering the intervening role of IFRS adoption among quoted companies in Nigeria.

Scholars have argued that corporate governance appears ineffective in monitoring income smoothing behavior because the accounting rules provide opportunities for managers to engage in such manipulative practices (Chi-Yih, Boon & Xiaoming, 2012). The validity of corporate reporting is being questioned by several academic researchers in accounting (Gulzar & Wang 2011; Ali & Marziyeh, 2012 Al Baaj, Al-Zabari, & Abbas, 2018) because of the probable effects of income smoothing practices by management of companies on information contents of corporate financial reports. Manukaji and Ijeoma (2018) note that the weaknesses of corporate governance mechanisms such as size of the board, board independence, audit committee and external auditors are perhaps the most important factors blamed for the income smoothing in Nigeria. Income smoothing can be detrimental to the firm or owners especially when repercussion occurs. Income smoothing practices can be linked to the collapse of high profile companies across the world like Enron (2001), Lehman brothers (2008), Intercontinental Bank Nigeria Plc (2010), Bank PHB (2010), FinBank (2010), Savanna Bank Nigeria Plc(2002). For instance, Enron in 2001 indicated that profits were overstated by as much as $586 million for four years, WorldCom in 2002 showed that operating expenses of $3.8 billion were capitalized thus overstating its profit, Tyco and Adelphia was estimated to the tone of $460 billion was said to have been lost, while Cadbury Nig Plc books were criminally manipulated by management leading to loss of over ₦15 billion (Okaro, Okafor & Ofoegbu, 2013).Ironically, a review of these studies shows that there appears to be no unanimity in the relationship between corporate governance and income smoothing. While some studies defend the position of a positive effect (Gulzar & Wang 2011; Ali & Marziyeh, 2012; Guo & Ying, 2015) others find a negative effect (Uadiale, 2012; Samak, El Said & El Latif (2014). These inconsistent implied that the relationship depends on the particular variable in question. This absence of a clear unanimity suggests that this issue is still open up for debates and there is the need to re-examine and provide additional perspectives to the impact or relationship between corporate governance mechanisms and income smoothing in Nigeria.

The broad objective of this study is to conceptually examine corporate governance and income smoothing over intervening role of IFRS adoption in Nigeria.

Specifically, the study seeks to theoretically determine the relationship between board size and income smoothing in Nigeria;

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2. LITERATURE REVIEW

Conceptual Review

Income Smoothening

Income smoothing is defined and viewed in different ways by accountings researchers and practitioners. Belkaoui (2006) defined income smoothing as the reduction of income fluctuations from year to year by transferring income from the years of high earnings for the periods that are less favorable. According to Ronen and Yaari (2008), income smoothing is an aspect of earnings management that is concerned with the dampening of fluctuations in earnings reported over a given period of time. In this situation, management of firm decides to take actions to increase earnings when earnings are relatively low and to reduce earnings when earnings are relatively high. Guillaume and Pierre (2016) claimed that income smoothing is practiced in accounting for the purpose of reducing the variability of the accounting results. Corporate managers may decide to smooth their own income (or security), assuming that income stability and growth rates are preferred than higher average income streams with greater variability (Samak, El Said & El Latif, 2014). Al-Baaj, et al, (2018) defined income smoothing as changing of expenses and revenue for the purpose of presenting deceitful imprint that a firm has stable earnings. Guillaume and Pierre (2016) view income smoothing as one of the incentives of accounting which is concerned with adjusting and manipulating fluctuations about some heights of earnings for the business. Chhabra (2016) noted that income smoothing are employed by management without inquiries from the stakeholders, for this reason the management does not disclose any information about it. .When it comes to the earning management there are two sentiments that entail. The first prevails and regards the earning management as false while in the second scenario the stakeholders determine such doings as management using their preferences Chhabra (2016). The main reasons that managers smooth earnings are: maximizing their own wealth, reducing the perceived riskiness of the firm, enhancing firm value, meeting debt covenants, reducing tax and political costs and enhancing the reliability of financial forecasts

However, executive discretionis not used only in earnings management. For Coelho and Lima (2009), the discretionary power of executives is also reflected in the degree of conservatism of firms. In essence, firms can be more or less conservative in their accounting policies, and that degree of conservatism affects their accounting results. Samak, El Said and El Latif (2014) maintained that there are two types of income smoothing: intentional, which is based on a real intention, and artificial income smoothing. Real (intentional) income smoothing indicates management actions that seek to control economic conditions that directly affect corporate earnings in the future. This kind of income smoothing affects cash flow. On the contrary, artificial income smoothing can show manipulation which is undertaken by management to smooth the earning. Francis, LaFond, Olsson, and Schipper.(2005) explain that smoothing helps in eliminating uncertainty regarding reported income, but meanwhile, can compromise the informational level with regards to the structure of company payments, which is of interest to investors. According to the international accounting standards, the process of income smoothing is not legal as it uses false accounting procedures and interpretations to stabilize fluctuations in net income (Acharya & Lambrecht, 2015). When businesses do income smoothing, there is no correct information to determine their actual earnings formerly to avoid taxes.

Corporate Governance

Corporate Governance was conceived out of the idea identified with the executives checking during the time spent great basic leadership. Ogbonnaya, Ekwe and Ihendinihu, (2016) state that corporate governance is essentially a matter of controlling the behavior of top corporate executives to protect the interest of company owners (shareholders). These problems arise because of the separation between owners and company management. The owners of the company as suppliers of capital can delegate their authority of the management of the company to professional manager.

La Porta, Lopez-de-Silanes, Shleifer, Vishny (2000) assert that Corporate Governance is a checking system planned to shield financial resources from misuse done by the insider. Liu, Harris, and Omar (2013) defines corporate governance as an internal mechanisms designed to enhance shareholders interest and facilitate managers to be transparent and accountable on issues related to companies' operations as well as decision makings. Shukeri and Md-Aminu (2012) define corporate governance as a kind of structure put in place by firms upon which they are controlled and directed to promote perpetuity of the organization, which is the sole concern of the management and the board of directors.Good corporate governance can be defined as an interaction between structures and mechanisms which ensure control and accountability, but still encourage efficiency and performance of the company. Alawattage and Wickramasinghe (2004) view corporate governance as practices that unite the structures with agents, the manner in which management are directed and transparent, as well as institutional rules, norms and laws. Corporate governance is not just issues of board activities and methods relating to management, boards, shareholders and other stakeholders but entire issues that can promote success in the firm (Chowdary, 2002).Cadbury (1992) defines corporate governance in terms of controls, financial or otherwise which ensure the firm is directed in the right way and towards the right direction. World Bank (2002) in its report sees corporate governance as a set of rules that have effects on the expectations about the exercises of control of resources in a company.

Corporate governance is the mechanisms and structures that serve as control over self-serving behavior of managers. Matters arising from issues of corporate governance (CG) is one that that garnered a lot of interest and one factor that can be said to be responsible for the volume of attention that corporate governance has received especially in recent times is the rising risk and possibility of corporate failure and this is a global issues, not just one that can be narrowed down to developing countries but even to developed countries. Corporate breakdown like Enron Corporation (US), Barings Empire (UK) and in Malaysia cases, for example, Perwaja and Pan Electric Inc., the bank crumple in Nigeria are altogether established in the absence of adherence to appropriate corporate governance framework. Hassan and Yaacob (2017), corporate governance is a mix of procedures and structures led by the governing body to approve, coordinate and administer the board towards the accomplishment of the organizational goals.

In Nigeria, Security and Exchange Commission (SEC) and Corporate Affairs Commission (CAC) in 2001 set up a seventeen (17) man committee led by MrPeterside Atedo to review extant corporate governance provisions with a view to identifying its weakness and means of improving on it (Obeten, Ocheni, & John, 2014). Javid and Iqbal (2010) indicate that good corporate governance practices can assist to protect rights of small or large investors, increase investments rates and as well assist to secure finance to execute projects and facilitate competitive capabilities.

Prior to the commencement of the Private Sector Code, different industries or sectors in Nigeria had bespoke codes of corporate governance (including the overarching Code of Corporate Governance for Public Companies). In issuing the Private Sector Code, the steering committee did consider such existing codes and similar directives with a view to harmonizing the codes and avoiding conflicts and overlaps with the Private Sector Code. In particular, the committee considered the Code of Corporate Governance for Banks in Nigeria Post-Consolidation 2006; Licensed Pensions Operators 2008; Insurance Industry in Nigeria 2009; the SEC Code in Nigeria 2011 and the Central Bank of Nigeria Code for Banks and Discount Houses 2014. The harmonized and unified various codes of the Private Sector Code supersede corporate governance codes in force in Nigeria with effect from 17 October, 2016, or before the date, and where there is a conflict between the provisions of the Private Sector Code and any sectoral code or supplement thereto, the provisions of the Private Sector Code shall to the extent of those inconsistencies prevail.

IFRS Adoption in the Nigeria

The growing acceptance of International Financial Reporting Standard (IFRS) as a basis for financial reporting perhaps represents a fundamental issue in the accountancy profession. Barth, Landman and Lang (2008) posit that IFRS reflects the combined effects of the features of financial reporting systems, the interpretation and enforcement of accounting standards and other environmental factors affecting managerial incentives. The use of accounting information cuts across borders when common yardsticks are used in preparing the financial statements (Leuz & Verrecchia, 2000). IFRS is aimed at promoting transparency, increasing quality and efficiency of financial reporting, providing financial statements that will engender investors' confidence (due to the robust disclosure requirements of IFRS) and facilitating cross-border stock exchange listing(Oseni, 2013). Fathi (2013)argued that the purpose of financial reporting is essentially to reduce information asymmetry between corporate managers and parties contracting with the firm and financial reporting reduces information asymmetry by disclosing relevant and timely information. The improvement of accounting quality brings positive desirable consequences (Soderstrom& Sun 2007) such as the lowering of the cost of capital and the improvement of the international capital mobility (Young &Guenther 2002).

Board Size and Income Smoothing

Board size entails the totality of members that constituted the board of directors of the company (Tafamel, Dania &Akrawah, 2016).Omoye and Eriki (2014) claimed thatthe size of the board is a fundamental issue of good corporate governance in both small and large firms as regards earning management practices. Hermalin and Weisbach (2003) stated that the possibility of larger boards can be less operational when compared with boards having small number of directors. They stated that when the number of directors on the board becomes too high, it tends to be more symbolic, instead of achieving its proposed function in the area of management. An effectiveness of the board of directors portrays how the decision power of directors that constituted the board influence the firm positively. The size of the board is paramount because could help in proper monitoring and supervising capability especially as more directors are introduced into the board (Jensen, 1993). He opined that larger boards could be less effective when compared to smaller boards. As size of the board increases, there is bound to be increase in agency problem (director free-riding) within the board and likely chances of being in effective.

Ahmadu, Tukur and Aminu (2011), argued that a large board size has a way of influencing the functions of the board greatly by means of good corporate governance structure. Fodio, Ibikunle and Oba (2013) also found that board size and board independence are negatively and significantly associated with earnings management for listed Insurance companies in Nigeria.

Theoretical Framework

This study is fastened on Agency Theory. Agency theory was credited to Jensen and Meckling (1976).Jensen and Meckling (1976) claimed that agency is a contract that exist between the principal (owner) and the agent (management), such that the agent is delegated some power to undertakes activities on behalf of the principal. This theory sets out that the principal (shareholders) are the owners of the companies, while the agent is management or appointed executive directors mandated with the authorities and responsibilities to carry out activities of the company (Clarke, 2004).The agency theory investors anticipate that the management should act and settle on choices that benefits shareholders. However, despite what might be expected, the management may not really settle on choices to the greatest advantage of the principals (Padilla, 2000). In agency theory, the management might be capitulated to personal circumstance, crafty conduct and missing the mark regarding harmoniousness between the goals of the principals and the management interest. Nonetheless, where there is a disharmony between principal and management, the organization model can be connected to adjust the objectives of the management to that of the proprietors. This theory recommends that information disclosure becomes germane to avoid the moral hazard problem that could arise between principal and managements. Therefore, improving the information environment of the organisation through an expansion of the disclosure such as in the context of this study pushing for more human capital disclosures, the moral hazard problem which is one of the major issues bothering on agency theory will be minimized."

In conclusion, the study adopts the agency theory as the appropriate theory for the study and the so selected because the theory examines corporate governance as a tool to address information asymmetry between management and shareholders. Also, the theory assumes that the interest of managers and shareholders have the potential to diverge. Therefore, the theory postulates that corporate governance costs are incurred to provide monitoring to ensure that misalignment between shareholders and management are minimized and expropriation tendencies of managers are curbed. Thus in the light of this, the agency theory perspective provides the basis for corporate governance to help reducing income smoothing.

Empirical Studies

Moh and Winny (2014) examined income smoothing evidence in Indonesia. The aim was to determine the factors that affect income smoothing on the National Private Commercial Foreign Exchange Banks that are listed in Indonesia Stock Exchange. Variables of the study were the firm size, profitability and financial leverage. Eckel Index (1981) was used to measure income smoothing. The sample was taken by random sampling of 10 private foreign exchange national banks that listed in Indonesia Stock Exchange (IDX) during the years 2009 to 2013 with a sub-sample of 50 financial reports. The results showed that income smoothing is done by most of the National Private Commercial Foreign Exchange Bank listed on Indonesia Stock Exchange (IDX). Size of the company, profitability and financial leverage were found to have significant effect on income smoothing.

Okougbo. and Elewechi (2015) conducted a study on corporate governance and earnings management, based on evidence produced from the accounts of listed companies in one of Africa's largest economies, Nigeria. The study employed Modified Jones model to estimate the discretionary accruals and data was analysed using regression The results reveal there is a positive significant relationship between the size of the board, return on assets and earnings management.

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Bala and Kumai, (2015) examined the influence of board characteristics and earnings management of listed food and beverages firms in Nigeria covering time period of six years 2009 to 2014. The statistical tool employed was OLS regression and the results from the analysis revealed an inverse relationship between board size, board meetings and board financial expertise, and earnings management of listed food and beverages firms in Nigeria, while and board composition and women directorship are positively significantly related to earnings management of listed food and beverages firms in Nigeria.

Obigbemi, Omolehinwa, Mukoro, Ben-Caleb and Olusanmi (2016) carried out an empirical investigation of the relationship between board structure and earnings management in Nigeria. The study sampled of 137 quoted companies in Nigeria for a period of 2003 to 2010. Earnings management was measured using discretionary accruals as estimated by modified Jones model and the statistical tool used was ordinary least square regression. The result showed that there is a significant relationship between board structure and earnings management practices in Nigeria, but revealed that there exists a significant negative relationship between board size, gender, and board composition and earnings management.

Manukaji (2018) examined corporate governance mechanism and income smoothing in deposit money banks in Nigeria. It covered a period of five (5) years (from 2012 to 2016) and Eckel (1981) index was employed in determining income smoothing. Multiple regression analysis was employed in analyzing the data. The study found that income smoothing of deposit money banks largely depends on the corporate governance mechanisms, particularly in the form CEO duality, ownership concentration and the existence of audit committee. Banks with ownership concentration may have higher propensity to smooth income. The empirical results also demonstrate that board size is not effective in monitoring income smoothing.

Khairul, Wan, and Yasin (2018) examined income smoothing perspective (deceptive or informative) by focusing at four audit committee attributes namely audit committee size, the number of audit committee meeting, the proportion of nonexecutive, and the proportion of independent audit committee members. A total of 604 public listed firms in Malaysia during the year 2008 to 2014 constituted the sample size. The study found that firms with strong audit committee, which have large audit committee, more frequent meeting and high proportion of independent directors are associated with low extent of income smoothing.

3. METHODOLOGY

This study employed library type of research. It is carried out by means of conceptual review of related literature. Secondary source of information is used. Theoretical reviews of various information were obtained from textbooks, journal articles, seminar and conference papers.

4. DISCUSSIONS OF FINDINGS

Having theoretically examined related literature on corporate governance in relation with income smoothing as type of earnings management, this study found inconsistency from results of extant studies. The findings are discussed respectively.

First board size as corporate governance mechanism showed significant influence, but negatively related with income smoothing. By implication, board size is a strong variable of corporate governance in enhancing income smoothing. Moh and Winny (2014) supported the finding such that board size was found to be significantly associated with earnings management for listed Insurance companies in Nigeria. Also Okougbo. and Elewechi (2015) revealed that relationship exists between board size and earnings management. Meanwhile, Obigbemi, Omolehinwa, Mukoro, Ben-Caleb and Olusanmi (2016) showed that board size is not effective in monitoring income smoothing practices of firms.

5. RECOMMENDATION

Following the findings and discussion, this study recommends as follow:

(1) The board of firms should be organised in such a manner that the size of the board reflect the firm size. It should be made of people with integrity and transparent characters capable of forestalling and reducing income smoothing as forms of earnings management practice.

6. CONCLUSION

This study centres on theoretical investigation of intervening role of International Financial Reporting Standards (IFRS) of corporate governance and income smoothing practices of firms. Corporate governance remain the frontline monitoring mechanism of management and thus research in this area has come to stay and likely to remain so for the foreseeable future. Agency theory has explained that corporate governance practices of firms can assist in resolving problem between managers and shareholders.

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