Financial Reporting Quality, Does Monitoring Characteristics Matter? An Empirical Analysis of Nigerian Manufacturing Sector.

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Abstract
This study examines monitoring characteristics and financial reporting quality of the Nigerian listed manufacturing firms. Financial reporting quality is represented with earnings management using the modified Dechow and Dichev's (2002) model. Using 32 firms-years longitudinal paneled of 160 observations, panel OLS is estimated and controlled for fixed/random effects. The result shows a significant positive relationship between monitoring characteristics and financial reporting quality. The Hausman specification test shows that the panel result after controlling for random, best suits the population as the fixed effect hypothesis was rejected by the Wald/Ch2 test. Of the control variables both returns on assets and return on equity are significant. Leverage, independent directors, audit committee, institutional, block and managerial shareholdings are all significant implying monitoring characteristics is influencing financial reporting quality of quoted manufacturing firms in Nigeria. What left to be done therefore is for the shareholders of the firms to ensure that the board of directors in Nigerian manufacturing firms should be composed in such a way as to ensure diversity of experience without compromising, compatibility, integrity, availability and independence and uphold debt to enable them check mate the manipulative accounting by management when preparing financial statements.

Introduction

Financial statements should always provide reliable information to assist users in decision making. The statement should disclose relevant, reliable, comparable and understandable information (Kamaruzaman, *et al* 2009). Reliability has to do with the quality of information which assures that information is reasonably free from error and bias and faithfully represents what it is intended to represent. However, Johnson (2005) argues that an annual report can never be completely free from bias, since economic phenomena presented in annual reports are frequently measured under conditions of uncertainty. Many estimates and assumptions are included in the report. Although complete lack of bias cannot be achieved, a certain level of accuracy is necessary for financial reporting information to be decision useful (IASB, 2008).

Therefore, it is important to examine the arguments provided for the different estimates and assumptions made in the annual report (Jonas and Blanchet, 2000). If valid arguments are provided for the assumptions and estimates made, they are likely to represent the economic phenomena without bias. Accounting information is reliable to the extent that users can depend on it to judge the economic conditions or events that it purports to represent. Reliability has the qualities of neutrality, representational, faithfulness and verifiability. Verifiability on the other hand means the ability through consensus among measurers to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias. For financial statement to be understood clearly, the presentation should not be misleading or ambiguous. Users should be able to understand the information presented without undue effort (IASB, 2008). To achieve this, the annual reports should contain full disclosure and higher level of transparency.

The quality of financial reporting is to promote transparency and deliver high quality annual report through comprehensive disclosure. This has contributed to the accounting standards setting and laws regarding financial reporting. The quality of financial reporting has always been an issue of interest among regulatory bodies, shareholders, researchers and the accounting profession itself. This is due to the fact that financial reporting has been a principal means of communicating financial information to outside users (Johnson, Khurana and Reynolds, 2002). The use of financial reporting itself is assessing the economic performance and condition of a business in the quest to monitor management's actions and assists in making economic decisions (Warren and Reeve, 2004).

Regulators can use research findings regarding determinants of financial reports' quality to further their understanding of the existing market for financial information before determining whether intervention is necessary. The responsibility for regulating accounting and financial reporting in Nigeria is shared by three main statutory bodies. The Corporate Affairs Commission (CAC), which is responsible for the supervision of company formation, registration, management, incorporation and winding up. The Securities and Exchange Commission (SEC) for regulating the capital market, and the Nigerian Stock Exchange (NSE), for ensuring compliance with the listing rules and reporting requirements for firms quoted on the exchange in addition to providing a trading platform for quoted equity and debt. Lastly, the Financial Reporting Council of Nigeria (FRCN) is responsible for the introduction, review and removal of local accounting standards. These legislations have the purpose to ensure the improvement of financial statements in respect of reliability and usefulness for decision-making, which should lead to a recovery of the public trust in financial reports. However, the possibility still exists for managers to perform discretionary behavior when they prepare financial statements. When managers have to give their own input to financial statements, they will try and benefit from the outcome of those numbers themselves. This might conflict with the usefulness of financial statements for stakeholders as they make decisions because financial statements might not reflect the true and fair value as it's supposed to be. However, as a result of this effect earnings management has on the quality of earnings, it is often used as a proxy for earnings quality and because of this on the quality of financial reporting (Blom, 2009).

Managers use flexibilities within the accounting standard to choose accounting methods, policies and estimates in reporting process to reflect firms' future prospect. Managers, can also use this flexibility to distort financial information in order to maximize their own utility. Evidence on the scope and frequency of earnings management therefore can help regulators adjust and determine the optimal level of management judgment and discretion. On one hand, if earnings management is widespread, regulators may consider additional disclosure requirements. On the other hand, if earnings management practice is infrequent, it may suggest a lack of communication between managers and investors, and standard setters may promote earnings management as a device to increase the value of financial reporting or as a form to facilitate effective communication. Gathering evidence regarding the scope and frequency of earnings management is also important because of its symptomatic relationship with earnings quality (Levitt, 2000). The notion of earnings quality is a major concern in evaluating an entity's financial health to indicate the reliability of reported earnings.

In Nigeria, institutions hold a substantial amount of equity shares of quite a number of firms. The implication of this is not known with certainty, because the previous studies that examined the impact of institutional ownership and earnings management have produced inconsistent results. Moreso, the attention on the developing countries whose economies are rapidly growing and have peculiar corporate control features, capital allocation and regulations have only recently gathered momentum (Bradbury, Mark and Tan, 2006: Firth, Fung and Rui, 2007). The differences in economies and level of sophisticatication of corporate governance mechanisms accross the globe call for such investigations in the Nigerian context. Further, most of the emperical studies of the effect of institutional investors on either corporate performance or opportunistic accounting have considered only one aspect of institutional presence in the firms within the study samples. Such approach can be deemed to be myopic as it may neglect an aspect of institutional involvement that can raise legitimate questions on the validity of the study results. In order to establish a relationship among variables, and to document reliable policy implication, requires an examination of different aspects of the research phenomena from monitoring perspective. Hence, the choice to consider five variables to capture the effect of monitoring in the sample firms on the opportunistic tendencies of managers.

In sum, three divergent views are debated globally in respect to firm characteristics and quality of financial reporting (Wallace *et al.* 1994 and Chen and Jaggi 2007). First, some are of the view that structure characteristics of firm play a prominent role in preventing managers from manipulating accounting numbers than other measures such as monitoring or performance variables. Second, others are of the opinion that monitoring mechanisms (independent directors and institutional shareholders) control better the opportunistic behaviour of management in preparing financial statements. The last view is of those that believe performance variables surpass both structure and monitoring elements in checkmating the unethical accounting activities by managers which reduces the quality of financial reporting. Thus, the three divergent views is still not resolved and to the best of our knowledge no study in Nigeria attempted to resolve the controversy especially in Nigerian manufacturing firms. Consequently, this paper investigates whether financial reporting quality represented by earnings quality of quoted manufacturing firms in Nigeria is likely to be influenced by their monitoring characteristics. As guided by literature, six variables are selected as proxies of monitoring characteristics. These variables are: leverage, independent directors, audit committee, institutional shareholding, block shareholding and managerial shareholding.

The contribution of this paper to the existing literature is that it enhances our understanding of the interaction between shareholdings by insiders (i.e. directors) and outsiders (institutional block-holders). We find a complementary (substitute) relationship between institutional block holding and board composition (directors' ownership) after controlling for endogeneity and other relevant biases.

The rest of the paper is organised as follows. Section 2 reviews the literature and present theoretical framework. Section 3 discusses the research methodology. Section 4 discusses the results. Finally, conclusions are drowned in Section 5.

Literature Review and Theoretical Framework

Nigerian financial reporting environment was empirically investigated by Wallace (1988), Okike (2000), Adeyemi (2006) and Ofoegbu and Okoye (2006). Wallace work is one of the pioneer studies on the Nigerian corporate reporting. His study won international recognition and accolade since this is the first work to show a detailed analysis of this subject empirically. He investigates the extent of disclosure using statutory and voluntary item, similar to the studies of Buzby (1975), Barrett (1975), McNally et al (1982) and Chow and Wong-Boren (1987). Wallace's choice of information items was relevant to the user group - accountants, top civil servants, managers, investors and other professionals. He uses a sample of 47 companies, 54% of the total population of listed firms quoted at the Nigerian Stock Exchange during 1982 and 1986. Disclosure is treated as a dichotomous item, 1 for an item disclosed and 0 for those not disclosed. The scoring system is informed by its intensity. Two types of disclosure indexes are constructed, unweighted and weighted. The weighted disclosure index reflects the preferences of the six-user groups. The result of the analysis reveals that companies which publish annual reports do not adequately comply with the disclosure regime. The overall disclosure index reveals the weakness in the disclosure practice in Nigeria, ranging from 37.55% to 43.11%. There is a high level of disclosure relating to balance sheet, historical items and valuation methods, whereas there are apparent weaknesses in status data, social reporting, income statement items and projections. His result is similar to the New Zealand study of Mc Nally (1982). Eight items not disclosed by any company in New Zealand are among the list of 26 items not disclosed by any company in this Nigerian study.

Further to the study of Wallace (1988), Okike (2000) investigates the corporate reporting practices in Nigeria. She observes that it is weak and accounting reports have been found deficient in the sense that they lack vital information. Ofoegbu and Okoye (2006) investigate the extent to which Statement of Accounting standards are complied with in Nigeria. Using a sample of seven standards (SAS 3, 7, 8, 10, 11, 18 and 19) conveniently chosen, they analysed the annual reports of 41 companies publicly quoted at the Nigerian Stock Exchange. It is discovered that there is a mixed result of compliance with disclosure requirements. Notably, full compliance (100%) is recorded for items such as: bases of determining book value of assets, cash flow presentations, disclosure of various forms of tax and movements of taxes and assets during the year. Partial compliance (ranging from 2% to 90%) is recorded for items such as:

frequency of revaluation policy, amount of foreign exchange gain or loss, maturity profile of risk asset of banks, and commission paid/received.

Audit committees have been long seen as a vital institution in assisting the board of directors in enhancing the transparency and integrity of financial information reporting Dan (2007). The code provided that the audit committee will be responsible for the review of the integrity of the banks' financial reporting system and oversee the independence and objectivity of the external auditors. Specifically, effective audit committees are expected to enhance financial reporting quality by fulfilling its numerous responsibilities including, commenting on and approving accounting policies, reviewing the financial statements, and maintaining and reviewing the adequacy of internal controls. Moreover, audit committees are also expected to play an important role in enhancing the effectiveness of external auditors over financial reporting quality by, assuming responsibilities for the appointment and remuneration of external auditors, and discussing the scope of and reviewing the auditors work. However, prior research indicates that the construct of audit committee effectiveness over financial reporting is multidimensional and is affected by variety of audit committee characteristics such as committee size (Anderson et al., 2004; DeZoort and Salterio, 2001), committee independence (Klein, 2002; Bedard et al., 2004) and committee number of meetings (Menon and Williams, 1994; Beasley et al., 2000). Audit committee member financial expertise is another important dimension of audit committee effectiveness that has gained the attention of regulators and academics (Treadway Commission, 1987; GAO, 1991; POB, 1993; Kalbers and Fogarty, 1993; DeZoort, 1997, 1998; BRC, 1999; SOX, 2002). Advocates propose that the presence of financial experts in audit committees do assist the committee in, critically analyzing accounting policies and financial statements, identifying potential problems, and solving them. Carcello and Neal (2000) provide support for this argument by documenting a relation between greater audit committee independence and the quality of financial reporting.

However, accounting expertise may be more important for audit committee members than any other expertise, since banks code of best practices (2006) suggest that audit committee members are responsible for tasks that require high degrees of accounting sophistication. Prior studies argue that financial reporting issues involve the highest level of technical detail among audit committee effective areas (Kalbers and Fogarty, 1993; Green, 1994), and ideal audit committee members should have knowledge of accounting concepts and the auditing process to enhance their understanding of the financial reporting process, recognize problems, ask probing questions of the management and auditor and make leadership contributions to audit committees (McDaniel et al., 2002; Libby and Luft, 1993; Bull and Sharp, 1989; Lipman, 2004; Scarpati, 2003). Archival evidence suggests that audit committee accounting expertise is negatively associated with SEC enforcements and restatements (McMullen and Raghunandan, 1996; Agrawal and Chadha, 2005) and suspicious auditor switches (Archambeault and DeZoort, 2001), and positively associated with firm credit ratings (Ashbaugh-Skaife et al., 2006) and the likelihood of supporting auditors in financial reporting disputes with management (DeZoort and Salterio, 2001). DeFond et al. (2005) document positive market reactions to the appointment of new audit committee members with accounting expertise, but no reactions to the appointment of audit committee members with non-accounting expertise. It is therefore likely that accounting expertise, relative to other expertise, can contribute more to the effectiveness of audit committees which in turn improve the quality of financial information.

Recent literature document that institutional investors have different incentives to monitor managers depending on the investment scope. According to Liu and Peng (2008), Chen et al. (2008) observe that independent long term investors with substantial ownership effectively monitor merger and acquisition decisions, while short-term investors give managers the latitude to achieve value-decreasing mergers and acquisitions. In this regard Liu and Peng (2008) note that dedicated institutions who are more interested in long term returns have stronger incetives to monitor managers than their transient counterpart. Empirical research supports this idea (Brickley, Lease, and Smith, 1988; Hartzell and Starks, 2003; Holderness, 2003; Jiambalvo, Rajgopal, and Venkatachalam, 2002; McConnell and Servaes, 1990).Given their large financial stake, institutional investors have incentives, resources, and the ability to monitor a firm's stakeholder policy. Recent research also indicates that the existence of stronger shareholders may improve internal control, and thus may be an effective monitoring device for improving financial reporting quality. To the extent that an appropriate power-sharing relationship between shareholders and managers reduces the moral hazard problems that lower overall firm value and allow shareholders to effectively monitor the financial reporting practice.

Institutional investors is an endogeneous governance variable that has been central in corporate governance discussions. The argument to categorize it as an endogeneous mechanism is supported by the fact that corporate disclosure, together with firm characteristics such as size, financial performance, and risk may affect institutional ownership and accruals quality simultaneously (Liu and Peng, 2008). Prior literature have acknowledged that institutional presence can serve as an effective monitoring mechanism in the firm (e.g. Bowen, Rajgopal and Vankatachalam, 2003: Shehu, 2011). Institutions are particularly important in corporate governance discussions because, in alot of cases, they hold a substantial proportion of total equity shares of a good number of firms and are thus relevant to policy makers. It is therefore, quite possible that these institutions have an effect on firm performance as well as the discretionery behaviour of managers. Perhaps, the predominant view is that because institutions have the required resources and financial expertise to monitor and discipline managers and thereby reducing agency problems (Schleifer and Vishney, 1997: Roodposhti and Chashmi, 2011). However, it can be argued that if institutions hold a large amount of equity shares of company, that in itself may exert an enormous pressure on the part of managers to manipulate earnings in order to please these institutions.

Another monitoring variables examined in the study is ownership concentration, which is also referred to as blockholders. It is the proprtion of shares (usually more than 5%) owned by a certain percentage of shareholders. It is argued that the higher the number of shares owned by the blockholders, the more the pressure on managers to act in comformity with shareholders interest (Sanda et al. 2005). Large ownership concentartion has more incentives to manage earnings because the expected benefit from equity holding in the firm outweighs the cost associated with monitoring managers (Ramsy and Blair 1993). If this is true, then we expect ownership concentration to be inversely related to earnings management. However, some researchers observe that high ownership concentration beyond a certain level may lead to abuse of power, which could be detrimental to the value maximization goal of the firm (Sanda et al. 2005).

Studies on the relationship between ownership concentration and earnings management also have yielded inconsitent results. Roodposhti and Chashmi (2010) find a negative relationship between ownership concentration and earning management, while they used 196 firms listed on Tehran Stoch Exchange as their sample for the period between 2004-2008, to examine the effect of board composition and ownership concentration on earnings management. In the same vain, Klai and Omri (2011), investigate the impact of corporate governance on financial reporting quality in Tunisia. The study used 22 listed firms for the period between 1997-2007. They find that ownership concentration is negatively associated with earnings management. Conversely, Using top 200 listed non-financial companies, Hashim and Devi (2008), examine the association between board independence, CEO duality and accruals management. They find that ownership concentration is associated with high income-increasing earnings management. Besides the exclusion of financial firms from all the studies mentioned above, economic differences of nations calls for an investigation in of similar problems in an economy like ours.

Devi and Aishah (2009) examine the relationship between internal monitoring mechanisms namely the role of board independence and the ownership structure (managerial ownership, family ownership and institutional ownership) and the financial reported earnings quality. Using data from 280 non-financial companies listed on Bursa Malaysia's Main Board for the year 2004, this study fails to find any significant evidence on the relationship between the traditional functions of board of directors (i.e. proportion of independent non-executive directors) and earnings quality measured by accrual quality model. However, this study finds positive significant associations between proportion of family members and earnings quality which suggest that concentrated shareholdings in family ownership have incentives to reduce agency costs through a better alignment of shareholder and managerial interests. Given the growing role of institutional shareholder in Malaysian capital market, it is interesting to note that this study find positive significant evidence on the relationship between institutional ownership and earnings quality. Concentrated shareholdings by institutional investors provide an incentive for diligent monitoring as they have the resources, expertise and stronger incentives to actively monitor the actions of management and improve financial reported earnings. The study used performance variables as control variables without transformation which could give a different result if use as continues variable in the model.

Nedal, Bana and David (2010) investigate the relationship between earnings management and ownership structure for a sample of Jordanian industrial firms during the period 2001-2005. Earnings management is measured by discretionary accruals. The three types of ownership studied are insiders, institutions and block-holders. Using the Generalized Method of Moment (GMM), the results indicate that insiders' ownership is significant and positively affect earnings management. This result is consistent with the entrenchment hypothesis which states that insiders' ownership can become ineffective in aligning insiders to take value maximizing decisions. Further analysis shows insignificant role for institutions and block holders in monitoring managerial behaviour earnings management. There are few limitations that exist in this study. Firstly, the study does not include companies that are not listed on Bursa Malaysia board, and also those companies that are categorized as financial institutions. Secondly, while Eckel's (1981) index identifies companies that artificially smooth their income, it may not identify all companies that attempt to do so. Finally, the study may lack external validity in the sense that since it is based only on companies listed on Bursa Malaysia, especially those companies whose companies' websites are available on the Bursa Malaysia website, thus the result obtained may not be applicable in other settings or situations.

The level of leverage has also been argued by past researchers to have an influence on financial reporting quality. In terms of the level of disclosure, Alsaeed (2006) argues that higher debt firms have higher agency costs and therefore need to have more information disclosed in order to satisfy the needs of creditors for information. A study by Craig and Diga (1998) had found a significant positive relationship between debt ratio and level of disclosure, while Alsaeed (2006) had failed to find it significant, whereby it was argued that this was probably due to the fact that the creditors may have shared private information with their debtors. In contrast, higher leverage company is argued to have higher bankruptcy risk, which in turn will lead to litigation risk (Rahman and Ali, 2006) and thus, increase management's tendency to manipulate firm's financial reporting to overcome this risk. This has been supported by findings by Klein (2002b) which showed that a company's leverage is significantly positively related to the level of abnormal accruals. Moreover, a study by Davidson, Stewart and Kent (2005) had also found a significant positive relationship between leverage and discretionary accruals. However, a subsequent study by Rahman and Ali (2006) and Yang and Krishnan (2005) did not document any significant relationship between company leverage and accruals.

Managerial ownership represents the interest of managers in the equity shareholding of a firm. The reason behind the rise of this corporate governance variable is rooted in the agency theory, which assumes that managers' equity holdings encourages them to act in a way that maximizes the value of the firm. Warfield et al. (1995) suggest that the interest of both shareholders and management starts to converge as the management holds a portion of the firms equity ownership. This implies that the need for intense monitoring by the board should decrease (Jensen and Meckling, 1976). Studies on the interaction between managerial shareholding and earnings management have revealed inconclusive results. Yeo et al. (2003) examined the relationship between managerial ownership, audit quality and earnings managent, using a sample consisting of 490 firm-year observations drawn from the firms listed on the the Stock Exchange of Singapore for the period between 1990-1992 . Their findings suggest that when management ownership is less than or equal to 25%, managers' oppotunistic behaviour is reduced. However, as it crosses 25%, management ownership is positively related with aggressive income-increasing discretionery accruals. Similarly, Johari et al. (2008) investigates the impact of board indepence, competency and ownership on earnings management. Using a sample of 224 firms listed on Malaysia Stock Exchange and employing different accruals estimation models, they find that management ownership is positively related with discretionary accruals in all models. This suggests that the higher the ownership of a firm's shares by its managers, the more the presence of earnings manipulation.

Conversely, You, Tsai and Lin (2003) examined the effect of managerial ownership on management adjustment of accounting accruals. With a sample of 393 corporations listed on Taiwan Stock Exchange between 1999 and 2000, the study documents a negative and significant relationship between managerial ownership and discretionery accruals. This study was conducted in China, a country which is inclined to the communist system of government is expected to have a different corporate governance mechanism and economic structure from that of Nigeria. Further, Hashim and Devi (2008) studied the interaction between corporate governance, ownership structure and earnings quality in Malaysia, using a sample of 426 non-financial firms listed on Bursa Malaysia Main Board for the period between 1999 and 2005. The study fails to establish any significant relationship between managerial ownership and the quality of financial reports. The same results are obtained even as they further segregated between inside and outside ownership. The results that could be obtained from similar studies mentioned above could have been different if conducted in Nigeria, given the differences in governance structures and level of economic developments.

Given that firms' financial statement is required by law (CAMA 2004) certain quality can be compromised by the management to achieve a given desired results. Thus, to measure the quality we hypothesized that financial reporting quality is a function of monitoring characteristics. The first two monitoring characteristics are firms' structure variables while the next three are ownership monitoring characteristics. The financial reporting quality is posited to be function of structure variables. This can be presented as follows:

FRQ = F (LEV, INDIR, AC) .... (i)

The firm structure variables are characteristics which could have an effect on quality of financial reports as explained by the opportunist theory. By definition, opportunistic earnings management is a term that is used to refer to self-interested managerial reporting behavior that is undesirable from a shareholder's perspective. A widely held belief in the literature is that earnings management is primarily opportunistic and it hampers earnings quality. Indeed, many studies have used discretionary accrual measures of earnings quality as negative proxies of earnings quality (Myers *et al.*, 2003; Defond *et al.* 2004; Schipper and Vincent, 2003). If earnings management were primarily opportunistic, it is reasonable to posit that such behavior would adversely affect both relevancy and reliability of accounting figures. Therefore, opportunist theory is used as theoretical framework in this study to anchored monitoring characteristics and financial reporting quality of listed manufacturing firms in Nigeria.

In addition, the ownership monitoring variables (institutional shareholding, block shareholding and managerial shareholding) are hypothesised to be function of financial reporting quality because they are believed to be capable of checkmating manipulative accounting activities by management. This can be presented mathematically below:

FRQ = F (IS, BS, MS) .... (ii)

A study on firm's characteristics as determinants of earnings quality document that larger independent board membership and larger institutional and block as well as managerial shareholdings are associated with lesser earnings management (Farber, 2005). Corporate monitoring by these variables can constrain managers' behaviour. Large institutional investors have the opportunity, resources, and ability to monitor, discipline and influence managers.

Consequently, since financial reporting is hypothesized to be function of monitoring characteristics in equation (i) and (ii) therefore, financial reporting quality can be said to be a function of both structure and ownership monitoring variables. This is mathematically represented below:

FRQ = F (LEV, INDIR, AC, IS, BS, MS)............ .... (iii)

Finally, the equation (iii) forms the basis of arriving at the model of the study using balanced panel data of multiple regression. This equation is represented as follows:

$FRQ = \beta_0+\beta_1 LEV+\beta_2 INDIR+\beta_3 AC+\beta_4 IS+\beta_5 BS+ \beta_6 MS+e$ .... *(iv)*

Where: FRQ = Financial Reporting Quality, β_0 *= Intercept,* $\beta_{1\text{-}7}$ *= Coefficient of the independent variables, LEV = Leverage, INDIR= Independent Directors, AC = Audit Committee, IS = Institutional Shareholding, BS = Block Shareholding, MS = Managerial Shareholding and e = error term*

Methodology and Robustness tests

For this study correlational research design is used. A correlational research design is used to describe the statistical association between two or more variables. It is therefore, most appropriate for this study because it allows for testing of expected relationships between and among variables and the making of predictions regarding these relationships. The population of the study comprises of all 59 quoted manufacturing firms in the Nigerian Stock Exchange as at 31st December 2011 which are classified into 4 subsectors namely the foods and beverages (21) firms, Building Materials (12) firms, chemicals and paints (13) firms and Conglomerates (13) firms. In view of the nature of the model used in the study, a filter is employed to eliminate some of the firms that have no complete records of all the data needed for measuring the variables of the study within the period (2007-2011). Consequently, 19 firms are eliminated leaving 40 firms. The second filter eliminates all firms that have disappeared from the trading schedule of NSE as at 31st December, 2011 on the basis of this filter, 8 firms are eliminated. The remaining 32 firms that met both criteria are used as the sample of the study. The study used longitudinal balanced panel data from secondary sources only because it is a quantitative study with positivism paradigm and the core of the data needed for analysis can be adequately and conveniently extracted from the audited financial reports of the selected firms within the period of the study. Multiple regression is adopted to examine the model of the study. Longitudinal panel data is used to account for individual heterogeneity of the sample companies. Two steps regression is used in determining the quality of financial reports of the Nigerian listed manufacturing firms adopting modified Dechow and Dichev's (2002) model. Thus, residuals of:

$$(\Delta WC_{it} = \beta_0 + \beta_1 CFO_{it-1} + \beta_2 CFO_{it} + \beta_3 CFO_{it+1} + \beta_4 \Delta REV_{it} + \beta_5 PPE_{it} + \varepsilon)$$

The residuals for the modified DD model after inserting the sampled firms' data represent financial reports quality in the second regression model specified for the study. However, the residual determines the accrual quality, the larger the residuals, the lower the quality of accruals vice versa as in McNichols (2002).

The results of robustness tests (multicollinearity, heteroscedasticity, cross-sectional dependence, test of serial correlation, Hausman specification and histogram test of residuals) conducted in order to improve the validity of all statistical inferences for the study reveal favourable but not reported for brevity.

Result and Discussion

This section presents the regression result of the dependent variable (FRQ) and the independent variables of the study (leverage, independent directors, audit committee, institutional shareholding, block shareholding and managerial shareholding). It follows with analysis of the association between dependent variable and each independent variable individually and cumulatively. The summary of the regression result obtained from the model of the study ***($FRQ = \beta_0+\beta_1LEV+\beta_2INDIR+\beta_3AC+\beta_4IS+\beta_5BS+\beta_6MS+e$)*** is presented in Table 1 below:

Table 1: Monitoring Characteristics and Financial Reporting Quality

Statistics	Beta Coefficients	t-values	Sig.
Variables			
LEV	0.002 **	2.01	0.050
INDIR	0.006**	2.05	0.030
AC	0.090*	2.52	0.003
IS	0.008**	3.22	0.026
BS	0.003*	3.37	0.001
MS	-0.005*	-4.29	0.000
R			**0.851**
R2			**0.783**
Adj R2			**0.660**
F. Statistic			**23.89**
Sig.			**0.000**
Durbin-Watson			**2.064**

Source: STATA Output Result

The cumulative correlation between dependent variable and all the independent variables is 0.85 indicating that the relationship between financial reporting quality and monitoring characteristics used in this study is 85% which is positively, strongly and statistically significant. This implies that for any changes in monitoring characteristics of Nigerian quoted manufacturing firms; their financial reporting quality will be directly affected. The cumulative R2 (0.78) which is the multiple coefficient of determination gives the proportion or percentage of the total variation in the dependent variable explained by the explanatory variable jointly. Hence, it signifies 78% of total variation in financial reporting quality of Nigerian quoted manufacturing firms is caused by their level of leverage, proportion of independent directors, audit committee, proportions of block shares, and shares held by institutions and managers. This indicates that the model is fit and the explanatory variable are properly selected, combined and used. This can be confirmed by the value of F- statistics of 23.89 significant at 1% level of significance. The Durbin-Watson value of 2.06 indicates that errors are uncorrelated to each other indicating absence of serial correlation within the period of the study.

The regression result reveals that leverage has significant effect at 5% level on earnings quality of Nigerian manufacturing firms with a positive coefficient. This implies that the more leveraged the manufacturing firms are the higher quality their earnings will be. However, more leverage firms improve the quality of information obtainable from their financial statements. This positive association supports the research result by Purnomo (1998), Kennedy (2003), and Hamzah (2007) among others. However, as leverage represents firm's capital structure, a high leverage suggests that the firm uses debt financing aggressively. The fund can be used to support long term growth for the firm so it can earn profit. This suggests that the firm's debt level has not yet reached the level of financial distress. The important of testing effect of leverage on the quality of earnings is of two faults. First, it is a measure for testing the information content of the balance sheet, which is widely used by investors, creditors and analyst to evaluate a firm and second, leverage as a proxy for financial risk of a firm, has supported the preposition that a firm's share price is conditioned by its financial leverage (Kim *et al*, 1992). Therefore, a high leverage firm is more likely to endure manipulations of financial statements' contents in other to manage the firm's exposure to accounting covenants and noise in the earnings stream.

Results regarding financial leverage have been divided into two categories through the literature. The first category of studies that find significant relationship between leverage and earnings quality include Courtis (1979), Schipper (1981), Chow and Wong-Boren (1987), Ahmed and Courtis (1992), Lau (1992), Malone *et al* (1993), Ahmed and Nicholls (1994), Hossain *et al.*(1994), Hossain *et al.*(1995), Ahmed (1996), Zarzeski (1996), Patton and Zelenka (1997), Craig and Diga (1998), Naser and Al-Khatib (2000), Bujaki and McConomy (2002), Camfferman and Cooke (2002), Ferguson, Lam and Lee(2002), Klein

(2002b), Naser *et al.* (2002), Eng and Mak (2003), Hassabelnaby *et al* (2003), Prencipe (2004), Al-Shammari (2005), Davidson *et al* (2005), Alsaeed (2006), Rahman and Ali (2006), Barako *et al* (2006), Hassan *et al* (2006), Abdelsalam and Weetman (2007), Barako (2007), Dwi *et al* (2009), Kamaruzaman *et al* (2009), Adelopo (2010) and Cristina (2010). However, the second category that finds no significant positive relationship between leverage and earnings quality are Chow and Wang-Boren(1987), Wallace *et al*(1994), Wallace and Naser (1995), Meek *et al*(1995), Raffournier(1995), Inchausti(1997), Owusu-Ansah (1998), Naser (1998), Tower *et al* (1999), Depoers (2000), Haniffa and Cooke (2001), Archambault and Archambault (2003), Ali *et al*(2004), Collett and Hrasky (2005), Yang and Krishnan (2005), Mangena *et al* (2007) and Nedal *et al* (2010). Our results are in line with the first group as we found a significant relationship between the degree of leverage and the level of earnings quality.

Again, the regression result reveals that independent directors as measured by the proportion of independent or non-executive directors on the board are positively related and statistically significant at 1% level of significant with financial reporting quality. This implies that the independent directors are free from managerial influence and capable of monitoring them efficiently which improve the quality of financial information conveyed to the users of financial statement in the Nigerian manufacturing firms. In addition, this study finds that the increase in the percentage of independent directors in the board has a positive role in determining the quality of earnings of Nigerian manufacturing firms. This may be as a result of outside members do not play a direct role in the management of the company, their existence may provide an effective monitoring tool to the board and thus produce higher quality financial reports. The finding is however consistent with prior studies by Fama and Jensen (1983), DeFond and Jiambalvo (1994), Beasley (1996), Dechow et. al (1996), Dechow, Sloan and Sweeney (1996), Peasnell *et al.* (2000), Gore *et al.* (2001), Dichev and Skinner (2002), Klein (2002a), Klein (2002b), Higgs (2003), Xie *et al.* (2003), Beekes *et al.* (2004), Bushman *et al.* (2004), Davidson, Stewart and Kent (2005), Jaggi and Leung (2005), Vafeas (2005), Karamanou and Vafeas (2005), Davidson *et al.* (2005), Firth *et al.* (2007), Ahmad and Mansor (2009), Davi and Aishah (2009), Denis *et al* (2009), Cristina (2010), Dimitropoulos and Asteriou (2010) and Nedal *et al* (2010). Contrarily, studies by Abbott, Park and Parker (2000), Jeanjean (2001), Abbott, Parker and Peters (2004), Abdullah and Mohd Nasir (2004), Kao and Chen (2004), Park and Shin (2004), Song and Windram (2004), Vafeas (2005), Abdulrahman and Ali (2006), Ahmed *et al.* (2006), Bradbury *et al.* (2006), Jaggi *et al.* (2007), Piot and Janin (2007) and Petra (2007) fail to find any significant evidence between independence of Directors on board and earnings management.

In addition, the result also reveals that the audit committee size, independent and frequent meetings determines it strength and quality of financial information in Nigerian listed manufacturing firms. The findings is in support of Anderson et al., (2004) that firms with larger audit committees devote more resources to oversee the financial reporting, internal control systems and facilitate quality discussions among audit committee members and DeZoort and Salterio (2001) who provide evidence that firms with larger audit committees are less likely to make suspicious auditor switches. However, for the committee independence it tallies with the findings of Klein, (2002); Bédard et al., (2004) and Anderson et al. (2004) depicting a positive relationship between audit committee independence and financial reporting integrity. Finally, Menon and Williams (1994) argue that audit committees that do not meet or meet only once are unlikely to be effective monitors while audit committees that meet several times exert more serious efforts in monitoring management therefore protecting earnings manipulation which improves the quality of financial information to be reported. Other supporting evidence indicates that firms whose audit committees meet less often are more likely to engage in fraudulent behavior (Beasley et al., 2000), face reporting problems (McMullen and Raghunandan, 1996), and make suspicious auditor switches (Archambeault and DeZoort, 2001). The evidence that firms with more members in the audit committee are more likely to have good quality financial reporting is in contrast with the evidence from previous studies such as Felo et al. (2003), Abbott et al. (2004) and Bedard et al. (2004), but consistent with Lin et al. (2006). This suggests that larger audit committees are more likely to be able to devote adequate time and effort to ensure that the information disclosed in the financial statements is accurate and timely and hence increase the quality of financial reporting.

Overall, the findings can provide guidance to users of accounting information such as investors and regulators. For users, our findings serve as a reminder that audit committees may appear to comply with regulatory requirements on independence, financial expertise and minimum number of meetings, yet in actuality they only play a ritualistic role with no substantive monitoring in the financial reporting process, in tandem with the institutional theory prediction (Cohen, Krishnamoorthy, & Wright, 2008). To help users make an informed decision on the quality of audit committee and to facilitate a sound assessment of "independence in substance", more qualitative disclosure is required on the activities of audit committees and the extent to which they have fulfilled their responsibilities. For the regulators, the efficacy of prescribing certain best practices for the audit committee remains an open question.

Further, looking at the relation between institutional shareholding and financial reporting quality, a positive relation emerged and it has been supported statistically at 5% level of significant. This significant association indicates that institutional investors are one of the major considerations in managers' aggressive earnings management strategy. This result is not surprising. In Nigeria, most institutional owners are social security institution (government pension funds) and financial firms. There is no existence of developed mutual funds or investment companies. As a result, institutional investors in Nigeria are effective in constraining managerial behaviour of earnings management through abusive accounting, income manipulations and smoothening. Consistent with the argument that institutional investors in Nigeria are short-term oriented and create incentives for managers of their portfolio firms to manage earnings aggressively, these institutional investors focus excessively on current earnings performance (Adelepo 2010). The result of influential effect of institutional investors on earnings quality found in this study is consistent with the findings of Brickley, Lease, and Smith (1988), McConnell and Servaes (1990), Edwards and Hubbard (2000), Claessen and Fan (2002), Jiambalvo, Rajgopal and Venkatachalam (2002), Abdul Wahab *et al.* (2003), Hartzell and Starks (2003), Holderness (2003), Wan and Ibrahim (2003), Chung *et al.* (2005), Mitra and Cready (2005), Velury and Jenkins (2006), Siregar and Utama (2008), Davi and Aishah (2009) and Nedal *et al* (2010) and contrary to those of Abdullah (1999), Wahal and McConnell (2000), Eng and Shackell (2001), Koh and Hsu (2003), Ajinkya *et al.* (2005), Chung *et al.* (2005) and Ahmad and Mansor (2009).

Considering the association between ownership concentration and financial reporting quality, the result reveals that ownership concentration is positively and significantly associated with financial reporting quality of listed manufacturing firms in Nigeria. This finding supports that of Klai and Omri (2011) in their sample of 22 non-financial firms quoted on the Tunisian Stock Exchange. It also extends the findings of Bradbury et al. (2006) and Firth et al. (2007), that large shareholders have the tendency to use their power to expropriate firms' resources, which increases earnings manipulation and information asymetry. However, the result contradicts that of Roodposhti and Chashmi (2010) who use a sample of Iran firms to document a positive and significant interaction between ownership concentration and financial reporting quality. Similarly, it also contradicts Farooq and Eljai (2012) who fail to document a statistically significant impact of concentrated equity shareholding on earnings management. This study outcome, therefore, objects to the argument of Yeo et al. (2003) that large shareholders play an active role in curbing the agency problem because they have a general interest in profit maximization and enough control over the asset of the firm. In fact, large acquisition of equity shares by few individuals in Nigerian manufacturing firms that form this study's sample leads to abuse of power which could jeopardize the value maximization of the firm. Thus, in our own case, ownership concentration has an entrenchment effect which decreases the earnings manipulation tendency of managers. The results also revealed a negative association between managerial ownership and earnings manipulation, but this finding is statistically supported. This implies that managerial shareholders do not reduce earnings management and hence decrease the quality of financial reporting. This revelation may be as result of the fact that, the managers holding shares of the sample firms are directly involved in the preparation of the financial statements. The finding supports that of Tsai and Lin (2003) which documents a negative and significant relationship between managerial ownership and discretionery accruals and contradicts that of Hashim and Devi (2008).

The study has several theoretical, practical and regulatory implications. These implications represent the contributions of the study which are expected to benefit the existing body of knowledge within the accounting research, regulators and providers of accounting services. Our findings have important policy implications since they suggest the need to encourage applying corporate governance principles by institutions and individual block-holders to provide effective monitoring of earnings management in Nigerian quoted manufacturing firms. These firms operate in the business environment of individual ownership domination and control, where managers have greater motivation and opportunity to manage earnings to maximize their private benefits. This suggests that similar efforts in other sectors especially financial institutions would be rewarding in controlling the management of reported earnings, to enhance the reliability and transparency of reported earnings in order to promote economic efficiency.

Furthermore, the effect of directors' independence on financial reporting quality of firms as showed by empirical evidence may find here a plausible explanation. This has significant policy implications for the composition of the board of directors. First of all, as already mentioned, parties that have long-term relationships with the firm as a going concern are natural candidates. As such, grey or affiliated directors; employees, block-holders to mention but a few may be highly valuable and their very position allows cognitive advantages over purely independent directors. Employees appear to be the best candidates among them, since workforce training in firm-specific capabilities and labour organization are main components of information quality determinants (Corrado *et al.*, 2006). In sum, our analysis points to the attractiveness of pluralistic board appointments, composed of independent members, corporate executives, affiliated members such as employees representatives and other parties with specific knowledge of the firms' business will go a long way in improving the capacity and capability of monitoring management to decline from earnings management discretion or opportunistic behaviour to benefit themselves at the detriment of the firm.

Conclusion and Recommendation

Agency theory demands that managers should act in a manner that is consistent with the value maximization objective of the firm. However, in practice, the positions that they hold triggers information asymetry which induces the managers to pursue their own interest at the expense of the firms that they manage. One of the strategies through which managers seek selfish gains is through the exploitation of accounting methods and choices within the regulatory framework. Researchers, practitioners and regulators have identified that ownership structure has the tendency to either allign with or entrench minority shareholders interest. In this paper, it has been statistically revealed that both ownership and struture monitoring characteristics have significantly impacted on earnings management in listed manufacturing firms in Nigeria. Based on the conclusion, it is therefore recommended that all the monitoring variables used in this study except managerial shareholding should be encouraged by the regulating agencies of government and all other stakeholders in the Nigerian manufacturing sector because of the role that the variables play in constraining managers to act opportunistically in preparing financial statements.

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