MONITORING ATTRIBUTES AND EARNINGS QUALITY OF LISTED CONGLOMERATE FIRMS IN NIGERIA

Munir Aliyu Saleh
Department of Accounting
Federal University Wukari, Taraba State, Nigeria
salehmuniraliyu@gmail.com +2347038422454

Umar Farouk Abdulkarim
Department of Accounting and Finance
Federal University Gusau, Zamfara State, Nigeria
elfarouk105@gmail.com +2348069393824

Isah Abdulkarim Ibrahim
Tax Investigation Department,
Federal Inland Revenue Service
adkusmaniya@gmail.com +23491241672

Abstract
This paper examines the effect of monitoring characteristics on earnings quality of listed conglomerate firms in Nigeria for the period of ten years from 2010-2019. As at 31st December, 2019, there were six (6) listed conglomerate firms in Nigeria and all were selected to serve as the sample using census approach. Three variables independent directors, audit committee and institutional ownership were used to represent monitoring characteristics. The Francis et al (2005) model was used as measure of earnings quality. Multiple panel regression was used to test the model of the study using Ordinary Least Square OLS regression and data was collected from the annual reports and accounts of the sampled firms. The findings of the paper revealed that two of the monitoring characteristics variables (IND and INST) positively and significantly affect earnings quality while AC has a significant but negative effect on earnings quality of listed conglomerate firms in Nigeria. It is therefore recommended that, board of directors of listed conglomerate firms should compose more of independent directors as it was found to have a significant positive influence on earnings quality, also their ownership structure should comprise more institutional shareholders as it has been found to improve earnings quality positively.

Keywords: Monitoring characteristics, Earnings quality, Conglomerates firms, Nigeria.

1. Introduction

The sole responsibility for the preparation of accurate and timely financial statements rests with management of a company. However, financial statements should disclose relevant, reliable, comparable and understandable information

(Kamaruzaman, et al 2009). This is because when these earnings are accurate and reliable, users of these financial reports will be able to make reasonable and informed decisions. However, it has been argued by Johnson (2005) that financial statement cannot be entirely accurate and unbias because some economic activities reported are measured under the condition of uncertainty. Therefore, as a result country round the globe Nigeria inclusive reviewed and or enacted policies to ensure the safety of shareholders' funds and to prevent future reoccurrences of corporate failures. Amongst the policies is the review of the harmonized corporate governance code of best practices to cover all entities in Nigeria. These corporate governance codes serve as a watchdog that is charged with the responsibility of checkmating managers opportunistic tendencies while preparing financial statements.

Several corporate scandals around the world has created doubt and mistrust in the eyes of investors and also destroyed investor confidence on corporate financial statement. For example, Enron, WorldCom, Xerox, Oceanic Bank and Skye Bank were involved in planned fraud and scandal in developed nations and Nigeria alike that left investors with loss of part or full investment. Therefore, in order to curtail managers' opportunistic behaviors and regain investors trust, international organizations for example, World Bank, the Organization for Economic Cooperation and Development (OECD) etc campaigned for the establishment of supervisory mechanisms to enhance effectiveness of corporate governance. This has however gained the attention of researchers around the world whom has given their quota of contribution to the literatures on corporate governance.

Supervisory mechanisms like the presence of independent directors on the board of a company will improve its capability to detect problems in financial statement. Strengthening the audit committee and presence of institutional investors can serve as a means of enhancing monitoring practices and quality of earnings reported. Therefore, monitoring characteristics are there to serve as check for the quality of the earnings reported by company managers. The importance of these monitoring characteristics on the quality of firms' earnings cannot be over emphasized, this is due to the fact that some of the managers tend to use the loopholes found in accounting principles to manipulate earnings and when these earnings are not reliable and verifiable, investors tend to make decisions that will be at their own detriment.

According to Shehu (2012), there are various obvious reasons that could result to smoothening of financial statements that ranges from demand for higher returns on investment by shareholders, the desire to be seen as a well to do firm in the eyes of competitors, also the need to satisfy the desire of others stakeholders. Managers usually get involved in smoothening of financial statement to overstate the profits in order to achieve a target(s). Manager's incentives are based on targets and they use earnings management to manipulate results in order to achieve the required targets (Leuz et al., 2016). However, the Nigerian regulatory agencies have shown less interest and pro-activeness in this uprising and are been lackadaisical by leaving problems regarding earnings management in the disguise of business ethics.

The relation between earnings quality and good corporate governance has been examined by previous studies using a variety of research designs and in various contexts. There are several researches that provided empirical evidence that there is a positive and significant relationship between some elements of monitoring and earnings quality Shehu (2013). Similarly, Bushman *et al* (2004), Karamanou and Vafeas (2005) argued that earnings quality increases as the number of independent directors increases. This means that, the higher the number of independent director on the board of a firm, the higher will be the quality of earnings to be reported. This is because the independent directors are watch dogs to the financial reports making sure that the reports presented by managers are true representation of the company's operation for a given period.

This paper aimed to determine the effect of monitoring characteristics on earnings quality of listed conglomerate firms in Nigeria. Amongst the monitoring characteristics examined by this study are; Independent directors, audit committee independence and Institutional ownership. In line with the objective of the study, the following hypotheses are formulated in null form:

Ho_1. Independent directors have no significant influence on earnings quality of listed conglomerate firms in Nigeria.

Ho_2. Audit committee independence has no significant impact on earnings quality of listed conglomerate firms in Nigeria.

Ho_3. Institutional shareholders have no significant impact on earnings quality of listed conglomerate firms in Nigeria.

The findings of this research will help directors of the company since they form part of the monitoring mechanism to enhance their frontiers of responsibility by been more vigilant and provide stronger and effective policies that can help reduce the opportunistic behavior of managers of a company. The government can use the findings of the study in its policy making and strategic decision making in area of business. These policies or strategic decisions can be provision of additional codes in the corporate governance code or any law, or standard that can foster development of businesses in the country and reduce opportunistic behaviors. This study will also add to the existing literatures in the field of monitoring characteristics and earnings quality by enabling researchers utilize the gap they find in other to develop new studies.

The remainder of this paper has the following organization; literature reviews and theoretical framework, research methodology, analysis and discussion of results, conclusion and recommendations.

2. Literature Review and Theoretical Framework

Earnings quality is quite a vague concept in financial reporting which is yet to have a formal definition and a generally accepted measure. However, Dechow *et al.* (2010) used the terms from the draft of Financial Accounting Standard Board to define earnings quality as: "Higher quality earnings provide more information about the features of a firm's financial performance that are relevant to a specific decision made by a specific decision maker". The research foundation of Certified Financial Analyst institution sees high-quality earnings as that which accurately shows the current operating performance of a firm, an indicator of future prospect of the firm, and a useful summary for measuring the value of a firm. Earnings quality is an honest expression of a company's activities by revealing the true picture of the company and its ability to strive in the future. There are various models developed by researchers to measure earnings quality and this is to fulfill a specific need of the researcher. However, the most used measures are; absolute value of discretionary accruals, earnings persistence, asymmetric or recognition, size of accruals etc.

The concept of Independent director is also a vague concept which has no universally accepted definition. The definitions available are those given by different people to satisfy their peculiar need. The code of corporate governance for private sector requires all companies listed in the floor of the Nigerian Stock Exchange to have a board which shall comprise of executive and non-executive directors and two-third members of the non-executive directors shall be Independent non-executive directors. These independent non-executive directors are required to have an insignificant holding in the company which should not exceed 0.1% of the total paid up capital of the company. This is done so that the interests they have in the company do not affect their independent judgment. Sandra (2014) believed that the presence of Independent directors on the board of a company can help improve the quality of earnings reported by mitigating managerial opportunistic tendencies in preparation of company's financial statements. According to her, there is high possibility of increase in earnings quality of company whose board comprises more of independent directors than executive directors. This is due to their ability to control and monitor the activities of those officers saddled with the responsibility of managing the affairs of the company.

Shehu (2013) in his paper - financial reporting quality, does monitoring characteristics matter? using 32 manufacturing firms listed on the Nigerian stock exchange covering five years (2007-2011) found that there is a significant positive association between monitoring characteristics and financial reporting quality. In his study, six independent variables (leverage, independent directors, audit committee independence, institutional investors, block shareholding, management shareholding) and the residuals of Dichev and Dechow (2002) was used to measure of the dependent variable financial reporting quality. The study is however restricted to only activities between 2007-2011, and therefore making it deficient and not all encompassing. So many activities have taken place after the study period that needs to be taken into account. Also the study used the residuals of Dichev and Dechow (2002) as the model to measure earnings quality, while there are better and new models like Francis *et al* (2005), Roychowdhury (2006) and so forth.

Hussaini and Idris (2014) examined monitoring characteristics and financial reporting quality of listed conglomerates firms in Nigeria where they looked at the association between monitoring characteristic and earnings quality. Their paper used all the nine listed conglomerate firms as its population and selected eight to form its sample. The study also covers a period of six years (2009-2014). They found that there exist a positive relationship between board independence, board meetings, audit committee independence, audit committee meetings and financial reporting quality of Listed Conglomerates Firms in Nigeria. While Board financial expertise, audit committee financial expertise and firm sizes are negatively significantly related to financial reporting quality of Listed Conglomerates Firms in Nigeria.

Shehu and Jibril (2012) studied audit firm characteristics and financial reporting quality of listed building materials firms in Nigeria using seven listed building materials firms in Nigeria covering a period of ten years (2001-2010) found that there is a significantly positive relationship between audit firm characteristics and financial reporting quality of listed building materials firms in Nigeria and concluded that for a firm to engage in a quality financial reporting, its audit firm characteristics is to be of stringent importance.

Again, Shehu and Saifullahi (2016) in their study titled “monitoring characteristics and financial reporting quality of Nigerian listed consumer goods firms”. They used purposive sampling technique to arrive at a sample of ten (10) firms out of a population of twenty-seven (27) listed consumer goods firms in Nigeria covering a period of nine (9) years (2007-2015). The findings of their study reveals that all the monitoring characteristics variables used in their study significantly affect the financial reporting quality of Nigerian listed consumer goods firms.

Omar (2017) investigated impact of audit committee characteristics on earnings management in the Pre- and Post- Bahraini Corporate Governance Code 2011”. His study covers only two years which are pre (2010) and post (2012) Bahraini corporate governance code 2011. He used a sample of 31 companies listed in the Bahraini Bourse. The findings of his study show that earnings management is not significantly associated with any of the audit committee characteristics and control variables used in the study.

Shehu & Musa (2014) examined firm attributes and earnings quality of listed Oil and Gas Companies in Nigeria using a sample of seven companies listed in the oil and gas industry covering five years’ period (2007-2011). Their findings reveal that, leverage, liquidity and firm growth significantly and positive affects earnings quality. However, institutional ownership, firm size, and profitability significantly but negatively influence earnings quality of listed oil and gas companies in Nigeria.

Mohammad & Ramezanali (2012) conducted an empirical study in Iran using a sample of 165 firms listed in Tehran stock exchange covering a period of six years (2005-2010) found that the number of non-executive directors on the board of the sampled firms will increase earnings quality. Also, the presence of executive directors on the board tends to improve earnings quality by lesser proportion. Firm size was also found to improve quality of earnings reported. However, they found a significant negative relationship between leverage and earnings quality.

This study is underpinned using the stakeholder theory because of the obvious significance of the theory. The theory seems to look at all individuals that are been affected by the operation of a company. This is followed by the corporate governance requirement that every company is to be accountable to the environment in which it operates, this environment includes all stakeholders of the company such as employees, shareholders, investors, customers, suppliers, creditors, competitors, government, the society and all those that are directly or indirectly affected by the decisions of the company.

3. Research methodology and Model Specification

This paper examines the effect of monitoring characteristics on earnings quality of listed conglomerate firms in Nigeria. In doing this, a correlational research design was adopted for the research because it is more appropriate in establishing the relationship and the extent to which monitoring characteristics affect earnings quality of listed conglomerate firms in Nigeria. The population of the study covers all six conglomerate firms listed on the Nigerian Stock Exchange for a period from 2010-2019. A census sampling approach was adopted which adopts six conglomerates companies listed on the Nigerian Stock Exchange as at 31st December, 2019 as sample. Multiple regressions was used for the analysis with STATA as tool. The data used in this paper were obtained specifically from the annual reports and accounts of the sampled conglomerate firms obtained from the website and NSE Facts Books covering the years of study.

Model Specification

To ascertain the effect of monitoring characteristics on earnings quality of listed conglomerate firms in Nigeria, a multiple regression model was built. The model captures the impact of independent directors, audit committee independence, and institutional ownership on earnings quality. This paper employs the Francis *et al* (2005) model which estimates earnings quality as prediction error or residuals from OLS regression as follows.

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

Where:

DAA_{it}= Discretionary Accounting Accruals,

β_0-β_5= Constant,

β_1-β_5= coefficients

CFO_{it-1}= Previous Cash Flow from Operating activities,

CFO_{it}= Present Cash Flow from Operating activities,
CFO_{it+1}= Future Cash from Operating activities,
ΔREV_{it}=Change in Revenue at time t,
PPE_{it} = Plant Property and Equipment
and ε. = Error term/residuals.

The regression model for testing the relationship between the explanatory variables and earnings quality is presented as follows:

$EQ_{it}= \beta_0+ \beta_1 IND_{it}+\beta_2 AC_{it}+\beta_3 INST_{it}+\varepsilon$
EQ=Earnings quality measured as residuals from the regression of Francis *et al* (2005) model
IND = Independent Directors measured as % of independent directors on the board
AC= Audit committee independence measured as % of non-executive directors on the audit committee
INST= Institutional Shareholders measured as proportion of shares held by institutions
β_0= Constant
$\beta_1 – \beta_3$= coefficients
ε= Error term.

4. Analysis and Discussion of Result

The results and the interpretations are presented under Descriptive statistics, Correlation matrix, and Regression result.

Table 1: Descriptive statistics

Variables	Min	Max	Mean	Standard Dev.
EQ	0.005	0.50976	0.083431	0.1018829
IND	0.111111	0.3	0.2108559	0.0639977
AC	0.333333	0.666667	0.445555	0.0979964
INST	0.4228	0.8795	0.6264027	0.1360577

Source: STATA output, 2020

The mean value of earnings quality of the sampled firms as shown above is 0.083431, while the explanatory variables IND, AC, INST have the average values of 0.2108559, 0.445555, and 0.6264027 respectively. The 63% average value for institutional shareholding indicates that over half of the shareholdings of conglomerate firms in Nigeria are held by institutional investors, while the remaining 37% is held by other class of investors. Since the mean value of the endogenous is relatively high, it therefore means low earnings quality. But this could be a result of the disclosure useful information. It is however observed that, amongst the explanatory variables, institutional ownership indicated a high standard deviation meaning that it contributes less to earnings quality.

Table 2: Correlation Matrix Table

Variables	EQ	IND	AC	INST
EQ	1.0000			
IND	0.1955	1.0000		
AC	-0.3846	0.2560	1.0000	
INST	0.1764	0.2260	0.2259	1.0000

Source: STATA output, 2020

The table above presents the correlation matrix of the dependent and independent variables as well the relationship among the explanatory variables themselves. The values were gotten from the Pearson correlation of two-tailed significance. From table 2 above, AC is negatively and significantly correlated to earnings quality of listed conglomerate firms in Nigeria. However, IND and INST are positive but insignificantly correlated to earnings quality of listed conglomerate firms in Nigeria. It can also be seen that all the independent variables are positively correlated and there is a very weak relationship amongst the independent variables themselves, indicating that colinearity isn't a problem. However, this may not be a result enough to conclude that multicolinearity exists until the variance inflation factor and tolerance values exceed their expected limits. Therefore, the tolerance value and the variance inflation factor (VIF) are two advanced measures of determining the existence of multicollinearity between the independent variables of the study. The VIF and tolerance as computed using Stata are found to be consistently lower than the standard level of ten and one respectively, indicating that multicolinearity isn't a problem.

Regression result

Table3: Summary of regression result

Variables	Coefficient	t-values	p-values	Tolerance	VIF
Constant	0.1187929	1.69	0.097		
IND	0.4352237	2.31	0.025	0.904673	1.11
AC	-0.5264097	-4.27	0.000	0.904709	1.11

INST	0.1714764	1.95	0.057	0.918713	1.09
R^2					0.2886
Adj. R^2					0.2505
F-stat.					7.57
F-sig.					0.0002

Source: STATA output, 2020

The cumulative R^2 (0.2886) which is the multiple coefficient of determination, gives the proportion of the total variation in the dependent variable (EQ) explained by the independent variables all together. Hence, it signifies that about 29% of the total variation in earnings quality of listed conglomerate firms in Nigeria is caused by independent directors on their board, audit committee independence, and institutional ownership. This indicates the fitness of the model and that the independent variables are selected properly and combined accordingly. This can be confirmed by the value of F- statistics of 7.57 significant at 1% level of significance.

Independent Directors and Earnings Quality

The regression result reveals that the independent directors as depicted in table 3 have a coefficient of 0.4352237, t-value of 2.31 and a P-value of 0.025. This indicates that the existence of independent directors on the board of listed conglomerate firms in Nigeria is positively and statistically related to their earnings quality at 5% level of significance. This implies that the independent directors are not under the influence of the management of the company, and hence help to monitor the opportunistic behaviors of this management and also help improve the quality of financial information conveyed to user of financial statements of listed conglomerate firms in Nigeria. This also shows that any increase in the percentage of independent directors on the board of listed conglomerate firms will help improve their earnings quality as well as the reliability of their financial report. Another important reason for this finding may be as a result of the fact that, independent directors' do not in any way participate in the management of a corporation, this may serve an efficient and effective mechanisms of monitoring the activities of managers and hence, provide some high quality earnings reported. The above findings are however consistent with the findings of; Shehu (2013), Saifullahi & Shehu (2016), Sandra (2014), Hussaini & Idris (2014) but contrary to those of; Firth *et al.* (2007), Ahmad and Mansor (2009), Dimitropoulos & Asteriou (2010) who did not find any significant relationship between independent directors and earnings quality.

Audit committee and Earnings Quality

The result of audit committee as a monitoring tool reveals that, audit committee has a significant effect on earnings quality of listed conglomerate firms in Nigeria. Table 3 depicts that audit committee independence has a coefficient of -0.5264097with t-value of -4.27 and a P-value of 0.000. This implies that number of non-executive directors on the audit committee strongly, significantly and negatively affects the quality of earnings of listed conglomerate firms in Nigeria. This means that, any increase in the number of non-executive directors on the audit committee will lead to a significant decrease in the quality of earnings reported by these firms. The reason for this result could be that the independence that some members of the committee have been jeopardized and it's rather in form, not in execution. This could be as a result financial or family connection they have with some members of the committee responsible for their appointment (Hamdan, Mushtapha & Al-Sartawi 2013). This finding is contrary to the findings of Shehu (2013), Klein (2002), Bédard *et al* (2004) and Anderson *et al*. (2004) who found a positive relationship between audit committee independence and financial reporting integrity.

Institutional ownership and Earnings Quality

Further, the regression result reveals that institutional shareholding has a t-value of 1.95, a regression coefficient of 0.1714764 and a P-value of 0.057. This implies that institutional ownership positively and significantly affects earnings quality of listed conglomerate firms in Nigeria at 5% level of significance. Therefore, any increase in number of shares held by institutional shareholders of listed conglomerate firms in Nigeria will significantly improve the quality of earnings reported by those firms. This result is not surprising because, institutional investors are effective in curtailing managers' opportunistic behavior of earnings management through abusive accounting, income manipulations and smoothening. The result of significant effect of institutional ownership on earnings quality found in this study is consistent with the findings of Shehu (2013), and inconsistent with the findings of Wahal and McConnell (2000), Eng and Shackell (2001), and Ahmad and Mansor (2009).

5. Conclusion and Recommendations

This paper investigated the impact of monitoring characteristics on earnings quality of listed conglomerate firms in Nigeria. The study used three variables (IND, AC, and INST) to represent monitoring characteristics and used the absolute values of residuals from Francis et al (2005) model to proxy the dependent variable (EQ) of the study. The findings of the study revealed that independent directors and institutional ownership positively and significantly affects earnings quality of listed conglomerate firms in Nigeria. However, audit committee independence depicted a significant but negative impact on earnings quality of listed conglomerate firms in Nigeria. Therefore, it can be concluded that, monitoring characteristics proxy by IND, AC and INST significantly affected the earnings quality of listed conglomerate firms in Nigeria.

Based on the findings of this paper, it is recommended that the number of independent directors on the board of conglomerate firms in Nigeria should be increase because it was found that any increase in the number will as well improve earnings quality tremendously. Similarly, the ownership structure of the firms should comprise more of institutional investors because of the watchful eyes they put on the management of companies which usually help reduce income smoothening by managers. Also precautionary measures should be taken in selecting the non-executive directors to the audit committee because the independence that come of the members of the committee has is by form than execution.

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