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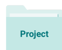

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RESEARCH ARTICLE

Top-Level Executives' Knowledge and Accrual-Based Earnings Management

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ABSTRACT

The study empirically investigated the impact of top-level executives' knowledge on accrual-based earnings management in 30 companies listed on the Nigerian stock exchange with a panel data set spanning the years 2010 to 2020. This study uses the Hribar and Collins (2002) model and the Kothari et al. (2005) model to calculate discretionary accruals. Consistent with the agency theory, the result reveals a significant negative relationship between the top-level executives' level of education and prior experience with the practice of earnings management for Nigerian firms. The empirical results show that increased education level and greater prior experience limits earning manipulating activities of top-level executives. Policy implications of the findings are discussed. Thus, the study recommends that companies in Nigerian firms should hire highly educated executives and executives with substantial prior experience because they mean fewer earnings management practices

Keywords: Panel Data, Accrual-Based Earnings Management, Top-level Executives, Education

1. Introduction

The business environment has created the opportunity for stakeholders and the market to harbor doubts and suspicion. Because of the impact on investment and management decisions, earnings manipulation studies are extremely important to both shareholders and stakeholders. The behaviors have a direct impact on financial reporting quality, as well as increasing imperfect information between management and shareholders. Earnings management is defined as the intentional intervention of financial reporting processes to obtain a private benefit (Schipper, 1989). Earnings management has long been regarded as a problematic and pervasive activity by practitioners and regulators as well as one of the most important topics in accounting research. Earnings management is often thought to have a negative impact on earnings quality and undermine the reliability of a company's financial statements since simple earnings management strategies can deceive market participants (Sloan, 1996)

Top-level executives, including CEOs and CFOs, meet frequently to make crucial decisions that affect the entire business and assist the company to achieve its objectives; the board of directors of a company is entrusted with overseeing and controlling the activities of managers who run the company for their gain. As a result, the board's participation in the company is focused on maintaining credibility, openness, and integrity in the report. As a result, top-level executives appear to play an important influence in a company's financial reporting tactics and are linked to the degree of earnings management.

Top-Level Executives' Knowledge and Earnings Management

Prior studies have defined earnings management as the deliberate improper implementation and abuse of accounting standards or a departure from normal business cycles, practices, and operations with the opportunistic goal of misrepresenting companies' reported earnings to influence contractual outcomes and intentionally misled unsuspecting stakeholders (Sianturia, Wahyudi, Pangestuti & Utomo, 2020). Because company management is responsible for providing reliable and relevant information to a range of users, the quality of financial reports can be judged by examining the extent of management involvement in earnings manipulation or earnings management.

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Chemmanur and Paeglis (2005) have shown that knowledgeable top-level executives have higher management quality. Top-level executives with greater management quality are more likely to identify projects with larger net present value for any given investment scale and implement them. As a result, the firm's performance improves while the executive's incentives to manipulate results fall. Top-level executives with greater management quality also have a better understanding of their customer base and macroeconomic situations, implying that they can more precisely estimate accruals (Demerjian et al., 2013). As a result, top-level executives are less likely to engage in earnings management practice. Managers' motivation to manage accrual earnings is reduced as top-level executives with more expertise are expected to be more reputed. A company with more educated and experienced top-level executives may have a harder time getting joint consent to participate in earnings management

Theoretical Literature

Several theories describe earnings management. The agency theory and the stakeholders' theory are the underpinnings of this study. Earnings are used by the capital market to determine whether a company engaged in value-adding activities during a given period, according to the agency theory (Waweru & Riro, 2013). The agency dilemma, according to Jensen and Meckling (1976), affects the accounting function when ownership and management are separated. As a result, an agency relationship exists when one or more shareholders hire another individual to act as their managers (agents) (Fama & Jensen, 1983)

One of the central claims of agency theory is that organizations with segregation in ownership and control are prone to agency issues between managers and shareholders (Jensen & Meckling, 1976). Lower earnings quality is one sign of agency difficulties, as noted, and according to agency theory, the board of directors (top-level executives) is a critical tool for restraining executive directors' opportunistic behavior.

While the stakeholder theory asserts that managers may try to influence earnings to pursue their interests and aspirations at the expense of shareholders and other stakeholders. The agency problem is explained by the agent (management) acting in their interest and an opportunistic manner on the expenditure of the principal (shareholders), as described by the agency theory (Jensen & Meckling, 1976).

2. Literature Review

A vast number of studies on earning management have been conducted. This paper will review studies that look at the influence of top-level executives' knowledge on accrual-based earnings management. Notably, the conclusions of the studies differ; whereas some showed that top-level executives' knowledge has a favorable impact on accrual-based earnings management, others showed the opposite. It is also worth noting that the results vary depending on the company and its management.

Klein (2000) investigated if the audit committee and board of directors' qualities are related to the firm's earnings management. The data demonstrate that audit committee independence and abnormal accruals have a negative relationship. The findings further showed a negative relationship between board independence and abnormal accruals.

Bala and Kumai (2015) used the random effect panel OLS technique to investigate the relationship of board characteristics and earnings management of listed food and beverage enterprises in Nigeria from 2009 to 2014. Their findings revealed that board size, board meetings, and board financial expertise have an inverse relationship with earnings management of listed food and beverage firms in Nigeria, while board composition and women board of directors have a positive relationship with earnings management of listed food and beverage companies in Nigeria. Salihi and Jibril (2015) analyzed the relationship between the size of the board of directors, the size of the audit committee, and earnings management in Nigerian consumer sectors companies in a sample of 29 companies from the Nigerian stock exchange consumer sector from 2010 to 2013. The findings revealed that the size of the audit committee has a negative and significant impact on earnings management. The findings also show that a larger board is ineffective in reducing the desire to manipulate earnings.

Enofe, Iyafekhe, and Eniola (2017) examined the impact of foreign directorship, female gender, the board size, board independence, and company size on earnings management in non-financial enterprises, using survey data from non-financial institutions listed on the Nigeria Stock Exchange in 2014. They found that foreign board members, female board members, and board independence were all found to be negatively related to earnings management. Hsieh et al. (2018) investigated 4791 Taiwanese listed businesses from 2006 to 2010 to see how top management team

(TMT) knowledge and average tenure affect accrual-based earnings management. The results reveal that TMT expertise and average tenure are negatively related to discretionary accruals. Olubunmi, Adeyele, and Pauline (2018) used the panel least-square approach to examine how the ownership structure and board characteristics of Nigerian listed deposit money banks (DMBs) affect aggressive earnings management. They found that private, international, and government shareholdings all have a negative and significant impact on aggressive earnings management.

Osemene, Adeyele, and Adinnu (2018) investigated how the ownership structure and board characteristics of Nigeria's listed deposit money banks (DMBs) impact aggressive earnings management during a 5-year period (2011-2016). The acquired data were analyzed using the panel least-square approach. They found that the length of a director's tenure has a significant impact on aggressive earning management, although the size of the board, gender, and business size had an insignificant impact over the study period. Azeez, Sukoharsono, and Andayani (2019) employed a sample of 71 firms picked from the top 250 corporations for one year (2016) to see if the board characteristics have any impact on earnings management among the multinational oil and gas corporations in the world. They found that board independence and gender diversity have a significant impact on earnings management reduction. The size of the board, on the other hand, has no impact on the practice of earnings management. Onwuchekwa and Madumere (2019) explored the relationship between board qualities and earnings management techniques for six years (2007-2012). They revealed that board independence and audit committee independence had a negative link with earnings management practices among Nigerian enterprises, whereas managerial shareholdings and board political connections have a positive relationship.

Ideh, Jeroh, and Ebiaghan (2021) used pooled data from the financial statements of ninety-two enterprises across ten industrial sectors to analyze the extent to which board independence and size influence the level of earnings management of publicly traded Nigerian firms from 2007 to 2018. They discovered that the size of boards and the presence of independent directors (board independence) incorporate boards had no significant impact on the level of earnings management in Nigerian firms when IFRS adoption and company age were introduced as mediating variables. Adewale, Kolawole, and Emmanuel (2021) used secondary data from various annual financial reports of 117 listed non-financial firms in Nigeria to examine the effect of board composition on earnings management of listed non-financial firms in Nigeria from 2009 to 2018. Their findings revealed that the board composition of listed non-financial companies in Nigeria had a significant and positive impact on earnings management.

Considering top-level executives are significant decision-makers for financial reporting quality, this study analyzes whether their knowledge influences earnings management. This implies that organizational decisions such as whether or not to control earnings may be made collectively by a group of executives; as a result, it is critical to consider how the top-level executives influence earnings management behavior. Prior research, on the other hand, has rarely addressed this topic. Prior accounting research has tended to focus on the entire character set of top-level executives rather than the impact of top-level executives' knowledge on earnings management. This study aims to close the gap by looking into the relationship between senior executives' expertise and earnings management in companies.

From the foregoing, Top-level executives' knowledge is an important factor for determining a firm's earnings management level. we propose the following null hypothesis to examine the relationship between top-level executives' knowledge and accrual-based Earnings

H_{01}= Top-level executives' level of education has no significant impact on the Accrual-Based Earnings Management

H_{02}= Top-level executives' level of experience has no significant impact on the Accrual-Based Earnings Management

H_{03}= Top-level executives' accounting certification has no significant impact on the Accrual-Based Earnings Management

3. Methodology

In this study, earnings management (discretionary accruals) is calculated using Hribar and Collins (2002) model and the Kothari et al. (2005) model. Discretionary accruals were used as a proxy to establish the extent of earnings management. The top-level executives' knowledge is being measured by the level of education of the executives, the level of experience of the executives, and the accounting certification of the executives. Our sample consists of 50 non-financial Nigerian companies**.** The data about relevant variables have been obtained from the annual report

and consolidated accounts published by the companies and proxy statements from the Nigerian Stock Exchange website. Consistent with prior studies (Osemene, Adeyele, and Adinnu (2018); Hsieh et al (2018)), this paper includes firm size and auditor hired as control variables.

The dependent variables, discretionary accruals are calculated with the two models. Following the Hribar & Collins (2002) model and the Kothari et al., (2005) model, different aspects of earning manipulation will be captured. The income statement is the basis of the Hribar and Collins (2002); it is presented as follows:

$$\frac{TAC_{i,t}}{A_{i,t-1}} = \beta 0 \frac{1}{A_{i,t-1}} + \beta 1 \frac{\Delta SALES_{i,t}}{A_{i,t-1}} + \beta 2 \frac{PPE_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t}$$

Where: $TAC_{i,}$= Total Accruals of the firm i in year t measured as follows

$A_{i,-1}$= Beginning total assets of firm i in year t

$\Delta SALES_{i,}$ = Change in sales revenues minus the change in accounts receivables of firm i in year t

$PPE_{i,}$= Property, Plant and Equipment of firm i in year t

$\varepsilon_{i,}$ = denotes unspecified random factors

The standardized residual of ($\varepsilon_{i,}$) is the primary proxy for discretionary accruals.

In addition, we measure discretionary accruals by using the Kothari et al. (2005) measured from the balance sheet approach. Kothari et al. (2005) modified the Hribar & Collins (2002) model by including a performance indicator, i.e. the return on assets (ROA). This model uses the accruals and the return on assets as a measure of corporate performance. The Kothari et al. (2005) model is presented as follows:

$$\frac{TAC_{i,t}}{A_{i,t-1}} = \beta 0 \frac{1}{A_{i,t-1}} + \beta 1 \frac{\Delta_s SALES_{i,t}}{A_{i,t-1}} + \beta 2 \frac{PPE_{i,t}}{A_{i,t-1}} + \beta 3\, ROA_{i,t-1} + \varepsilon_{i,t}$$

Where:

$ROA_{i,-1}$= Return On assets, the ratio between the net income and total assets at the beginning of the period.

To investigate how Top-level executives' knowledge affect a firm's earnings management level, this work adopts panel OLS regression. The estimated model is:

$$|\boldsymbol{DAC}_{i,t}| = \boldsymbol{\alpha}_0 + \boldsymbol{\alpha}_1 EDU_{i,t} + \boldsymbol{\alpha}_2 ACC_{i,t} + \boldsymbol{\alpha}_3 EXP_{i,t} + \boldsymbol{\alpha}_4 AUD_{i,t} + \boldsymbol{\alpha}_5 SIZE_{i,t} + \mu_{i,t}$$

Where μ = the error term

$EDU_{i,t}$ = the level of education of the executives.

$ACC_{i,t}$ = accounting certification of the executives

$EXP_{i,t}$ = the level of experience of the executives

$AUD_{i,t}$ = the auditor hired by the firm(AUD equals 1 if a firm hires Big 4 auditors and 0 otherwise).

$SIZE_{i,t}$= the firm size

4. Empirical Results

The descriptive statistics for discretionary accruals in absolute value are presented in Table 4.1 and the descriptive statistics for independent variables are presented in Table 4.2.

Table 4.1: Descriptive Statistics for Discretionary Accruals in Absolute Value

	Approach	Mean	Std. Dev	Min	Max
DAC1	Hribar and Collins (2002) model	0.688631	0.401799	0.086027	3.535674
DAC2	Kothari et al. (2005) model	0.388599	0.579339	0.092557	0.557585

Source: Authors' computation, 2022

For the two alternative models, the mean of the absolute value of discretionary accruals is significant, indicating the presence of earnings management methods in Nigerian enterprises. This demonstrates that Nigerian businesses tend to hide their failures and lower the quality of financial and accounting data.

Table 4.2: Descriptive Statistics for Independent Variables

	EDU	ACC	EXP	AUD	SIZE
Mean	5.612924	1.137435	1.112093	0.696049	1.001864
Median	6.548434	1.079181	1.158043	1.000000	1.010940
Maximum	7.576555	1.885129	1.885129	1.000000	1.885129
Minimum	1.716540	-1.072630	-0.159079	0.000000	-1.072630
Std. Dev.	1.780213	0.437432	0.424426	0.460663	0.533055
Skewness	-0.758056	-0.996471	-0.520863	-0.852456	-0.988214
Kurtosis	1.913747	5.955375	3.057390	1.726681	4.939274

Source: Authors' computation, 2022

Table 4.2 showed that Level of education (EDU) which has a mean value of 5.612924 units and a high standard deviation of 1.780, coupled with a negative skewness value of 0.758 units to left and a low kurtosis value of 1.913747 which is less than the compulsory 3 units further suggested that presence of highly educated executives in the sampled firms. Similarly, accounting certification (ACC) has a mean value of 1.137435 units and a high standard deviation of 0.43742 units, negative skewness of -0.996471, and kurtosis value of 5.955371 which is more than the benchmark of 3 units implied that a large proportion of executives were highly certified accountants in the sampled firms. Level of experience (EXP) with the mean value of 1.112 and low standard deviation of 0.424426 coupled with negative skewness value of - 0.520863 units and moderate kurtosis value of 3.057390 units indicating that a greater proportion of the top-level executive of the sampled firms has a high level of experience. The auditor hired variable has a mean value of 1.000, it suggests that sampled firms were at an average of 1 indicating that on average the sampled firms hired big 4 auditors. Finally, firm size (FSIZE) measured with natural logarithm revealed a mean value of 1. 0018 units and a standard low deviation of 0.533055 units suggesting that the sampled firms were large running into billions of naira.

Table 4.3: Panel Unit Root Test Result

Variables	Levin et al		Order of Integration	Variables	Im et al		Order of Integration
	Levels	First Diff.			Levels	First Diff.	
DAC1	-4.49259**	-	I(0)	DAC1	-1.56764	-2.97838**	I(1)
DAC2	-1.90661**	-	I(0)	DAC2	0.87270	-3.44088**	I(1)
EDU	-2.20294**	-	I(0)	EDU	1.64298	-5.24627**	I(1)
ACC	-1.46620	-4.15399**	I(1)	ACC	-0.41935	-2.88149**	I(1)
EXP	-3.19884**	-	I(0)	EXP	-1.22263	-7.79040**	I(1)
AUD	-9.47681**	-	I(0)	AUD	- 6.33141**	-	I(0)

SIZE	-1.96575**	-	I(0)	SIZE	-0.94530	-6.30971**	I(1)

Source: Authors' computation, 2022

Notes: Values reported are t-statistics value.
***** denote significance 5 percent.***
The test was conducted with the assumption of intercept and no trend in both Levin et al (2002) and Im et al (2003) specification

Table 4.3 demonstrates that since both unit root tests generated different results, it's unclear if most of the variables are integrated at levels (I(0)) or first difference (I(1)). Thereafter, the data sample is subjected to a panel cointegration test, which is plausible. It is used to figure out whether the model predicts a long-term relationship.

After the unit-roots of the series have been explored, a cointegration analysis is performed. The Kao cointegration approach for the panel cointegration test is used to assess the long-term relationship between the variables. As indicated in Table 3, the ADF t-statistic probability value is less than a 5% level of significance, implying that the variables in the model have a long-term association. As a result, the null hypothesis is rejected, indicating that the variables are cointegrated. The findings demonstrate a long-term association between the variables, confirming the validity and consistency of empirical findings.

Table 4.4: Kao Residual Cointegration Test Result

DAC1		**DAC2**	
ADF t-statistic	Probability	ADF t-statistic	Probability
-1.813916	0.0348**	-2.465891	0.0068

Source: Authors Computation, 2022

Note: Null Hypothesis: No cointegration.
***** denotes significance at 5 percent***

The panel OLS estimate approach is used to study the association between top-level executives' knowledge and earnings management because the model comprises a long-run relationship. The results of the panel OLS method are shown in Table 4.5.

Table 4.5: Panel Regression Results

Dependent Variable	**DAC1** **Hribar and Collins (2002) model**	**DAC2** **Kothari and et al. (2005) model**
EDU	-0.189878 (0.0002)	-0.085369 (0.2039)
ACC	0.099857 (0.0659)	0.119558 (0.0516)
EXP	-2.69E-08 (0.0000)	-0.251483 (0.0011)
AUD	-0.000173 (0.0000)	0.259904 (0.0007)
SIZE	-0.002479 (0.0987)	-0.096699 (0.00000)
Constant	1.425613	0.091002
R^2	0.277579	0.151632
F statistics	22.43927 (0.000000)	0.689932 (0.00000)
Auxiliary Parameters		
Hausman Test	9.947948 (0.0767)	8.125723 (0.1494)

Source: Authors' Computation, 2022

Standard errors are in parenthesis.
t-statistics is in square bracket.

*****denotes significance at 5 percent*.**

Findings and Discussion

The F-statistics for the two models is significant at the 5% level of significance. The Education level of the top-level executive variable has a negative coefficient of -0.189878 in the Hribar and Collins (2002) model, indicating that an increase in the level of education reduces the practice of earnings management. The education level variable also has a negative coefficient of -0.085369 in the Kothari et al. (2005) model which also shows an inverse relationship between education level and the practice of earnings management. The p-value of the education level variable in the Hribar and Collins (2002) model is 0.0002, which indicates significance at a threshold of 5% significance. The education level variable's regression coefficient was determined to be significantly different from zero. The p-value of the education level variable in the Kothari et al. (2005) model is 0.2039 which indicates that the variable has an insignificant impact on accrual-based earnings management.

The accounting certification of top-level executives has a positive coefficient in the Hribar and Collins (2002) model and Kothari et al. (2005). The coefficient of the accounting certification variable in the two models indicates that an increase in the accounting certification increases the practice of earnings management. The P-value of the coefficients is higher than the 5% level of significance which shows that the accounting certification of top-level executives does not have a significant impact on the practice of earnings management in the two models.

The level of experience of top-level executives has a negative coefficient of -2.69E-08 in the Hribar and Collins (2002) model and the variable also has a negative coefficient of -0.251483 in the Kothari and et al. (2005) model. The probability value of the variable in the Hribar and Collins (2002) model and Kothari et al. (2005) is greater than the 5% level of significance showing that the level of experience has a significant impact on the practice of earnings management in the Hribar and Collins (2002) model and Kothari and et al. (2005).

The Auditor hired has a negative coefficient of -0.000173 in the Hribar and Collins (2002) model and a positive 0.259904 in the Kothari et al. (2005) model. The probability value for the auditor hired is 0.0000 in the Hribar and Collins (2002) model and 0.0007 in the Kothari et al. (2005) model. This shows statistical significance at the 5% level of significance in the two models. The Hribar and Collins (2002) model shows a negative significant impact on the practice of earnings management while the Kothari et al. (2005) model show a negative significant impact on the practice of earnings management

In the Hribar and Collins (2002) model, the coefficient of firm size has a negative value of -0.002479 and the probability value of 0.0987 is not statistically different from zero at the 5% level of significance. In the Kothari et al. (2005) model, the coefficient of firm size has a negative value of -0.096699 and the probability value of 0.00000 is statistical significance at the 5% level of significance.

Overall, based on the Hribar and Collins (2002) model, the above empirical results reject two of the three null hypotheses stated earlier; it indicates that the top-level executives' education level and prior working experience significantly impact a firm's earnings management level. This shows that the more educated and more experienced a company's top executives are, the more aware they are of the legal costs of earnings management which enables them to desist from the practice of earnings management. The top-level executive will also be less likely to reach a consensus to manipulate earnings. The results of the Hribar and Collins (2002) model also highlight the negative and insignificant impact of accounting certification on the earnings management practices of firms. Alternatively, the empirical result of the Kothari et al. (2005) model rejects only one of the hypotheses stated earlier since it shows that the level of experience of the top-level executives negatively and significantly impacts the earnings management practices of firms.

5. Conclusion

The purpose of this study was to examine the impact of top-level executives' knowledge on accrual-based earnings management in Nigeria. It analyses how top-level executives' knowledge influences the extent of earnings management practices in Nigerian firms. The data consisting of 30 non-financial companies listed on the Nigerian stock exchange was estimated with the panel least square method of estimation using data gathered from the annual report and consolidated accounts published by the companies. The results of this study are robust to alternative model specifications such as employing different earnings management measures. The two models show different results. In the entire sample, the Hribar and Collins (2002) model suggest that top-level executives' education level and prior working experience significantly and negatively impact a firm's earnings management

level. The outcomes of this study suggest that more educated and more experienced top-level executives desist from earning management practices. Top-level executives with a lower level of education and little prior experience are more likely to reach a consensus to select income-increasing accounting procedures. In addition, the negative association between education level, level of experience, and earning management practices is also supported by the reason of the managers evading investment in projects that are non-value maximizing, which control the creation of accruals in the firms. The Kothari et al. (2005) model shows that the top-level executives' level prior experience significantly and negatively impacts earnings management while education level and accounting certification of the top-level executives do not significantly influence the practice of earnings management.

The findings of this study have significant policy implications for Nigerian firms seeking to eliminate the activities of executives that engage in opportunistic gain to the detriment of the firm. For companies, the impact of accounting certification on earnings management is reduced. High levels of education and experience have a significant impact on a company's degree of earnings management. As a result, the study suggests that companies in Nigeria should hire as many highly educated executives and executives with significant experience because they mean fewer earnings management practices.

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