Volume 10, 2024, 151-158 https://doi.org/10.5281/zenodo.#

DO CORPORATE BOARDS REMUNERATION COMMITTEE ATTRIBUTES MITIGATE ACTUAL ACTIVITIES' FINANCIAL RE-ENGINEERING AMONG LISTED COMPANIES IN NIGERIA? A STUDY OF THE NIGERIAN CORPORATE GOVERNANCE LANDSCAPE

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Abstract

In the contemporary corporate landscape, appropriate governance frameworks encompass, but are not restricted to, well-functioning corporate board committees that guarantee the management's proper utilization of the enterprise's resources and accurate reporting of its economic status and operational efficacy in the most pertinent manner. The accurate and utmost-faithful-representation of the financial statement as a whole is a key reason the study investigates empirical evidence to elucidate and forecast the statistical relationship between the characteristics of remuneration committees on corporate boards and the financial re-engineering of actual activities. The study deployed an ex post facto research design. The study's data were gathered from the annual reports of 74 companies over an 11-year period from 2011 to 2021; a total of 814 observations were evaluated using least squares regression techniques. The study found that remuneration committee independence (RCIND) and diligence (RCDIL) have a significant negative impact on efforts for financial re-engineering of actual activities (RAFRE) (p-values 0.0000 and 0.0000 < 0.05; F-stat 16.84 and 13.67, respectively). Additionally, measures of remuneration committee potentials have a substantial adverse influence on efforts for actual activities' financial re-engineering (RAFRE) (p-value 0.0000 < 0.05; F-stat 11.23). The study finds that increasing the amount of RC qualities (independence and/or diligence) will dramatically reduce fundamental financial re-engineering activities in Nigerian companies. It was suggested, among other things, that listed companies maintain a high degree of independent directors as a viable weapon in combating management tendencies and efforts aimed at actual activities' financial re-engineering.

Keywords: Corporate Boards, Remuneration Committee Attributes, Independence, diligence, Financial Re-Engineering, Actual activities, Growth Opportunity, Faithful-representation.

1. Introduction

In today's corporate environment, good governance structures which include a thoughtfully composed (diversified) board of directors, a balanced ownership structure, adequately functioning board committees etc. that make sure that the companies' management properly utilize the enterprise's resources within the best interest of absentee owners, and fairly report the economic condition and effective operation of the enterprise in the most relevant and with utmost-faithful-representation of the financial statement as a whole, forms top priority for the economic process that engenders the growth of any country (Bansal & Sharma, 2016, Efenyumi, 2023).

Most countries today establish novel standards of better governance tactics to align managers' interests with shareholders' wealth maximisation objectives. Accordingly, the rekindled and growing concern for better governance practices among Nigerian companies, informed the Federal Government of Nigeria passing into law the Financial Reporting Council of Nigeria ACT 2018, which releases the Nigerian Code of Corporate Governance (NCCG, 2018) which is general for the listed and non-listed companies in Nigeria taking effect from January 2020 and that corporate governance is a factor, that not only determines whether management will engage in financial re-engineering or not but central to fraud and crime control (Jeroh & Efenyumi, 2022; Dabor & Ibadin, 2013; Egbunike, Okafor & Okegbe, 2010).

Business firms are currently facing significant governance issues pertaining to board sub-committees composition and onuses. Previous studies (Akhtaruddin & Haron, 2010; Efenyumi, Nwoye & Okoye, 2022) have extensively discussed how the independence of the board enhances governance effectiveness. However, the attributes (independence and diligence) of the board sub-committees especially the remuneration committees in relation to their monitoring role, which are crucial for ensuring effective governance, have received less attention.

Notwithstanding, numerous scientific explorers have investigated fundamental earnings or the probable exchangeability of actual and accrued earnings. (Cohen & Zarowin, 2010; Ugbede, Lizam & Kaeseri, 2013; Egbunike, Ezelibe & Aroh, 2015; Abata & Migiro, 2016, Al-Haddad & Whittington, 2019). Empirical research shows that many previous studies in Nigeria predominantly relied on the Jones model or its modified version, which did not sufficiently address the impact of actual activity manipulation on the quality of earnings disclosed by companies. This however creates another empirical gap that needs to be filled.

Despite the significant role played by the remuneration committee and its potentials to reduce agency problems and discourage actual activities' financial re-engineering due to unfaithful representation, together with the dearth of empirical studies in Nigeria examining the attributes of this board sub-committee's influence on actual activities' financial re-engineering. This near absence of research on remuneration subcommittee hinders our understanding of how the remuneration committee can contribute to enhanced and strengthen quality reporting of earnings. In this light, the study intends to objectively examine the influence of the corporate boards remuneration committees attributes on the financial re-engineering of companies' actual activities in Nigeria. The study seeks specifically to:

i. Evaluate Remuneration Committee Independence significantly predict actual activities' financial re-engineering.
ii. Assess the influence of Remuneration Committee Meetings (Diligence) on actual activities' financial re-engineering.
iii. Determine the statistical impact of the joint attributes of Remuneration Committee Independence and Diligence on actual activities' financial re-engineering.

2. Empirical review and Hypotheses development

2.1 Corporate Board Subcommittees

As enshrined in the NCCG (2018), the company board in a bid to function optimally and without relinquishing its tasks in its oversight functions, has been empower and entrusted with authority to established well-structured independent BOD Stand-alone Committees: nomination and governance, remuneration, audit and risk management; with a minimum of three directors.

2.1.1 Remuneration Committee (RC)

In line with the updated Nigerian Code of Corporate Governance (2018), which outlines the principles and recommendations for corporate governance, it is recommended that the remuneration committee primarily constituted with Non-Executive Directors (NEDs), with a focus on Independent Non-Executive Directors (INEDs). This approach aims to address potential conflicts of interest that may arise when individuals responsible for setting remuneration policies also stand to benefit from them. Earlier research, such as that by Jeroh and Efenyumi (2022), has mainly investigated how board diligence and independence, along with the role of corporate committees, affect performamce and earnings management. Although much earlier studies on earnings quality largely highlighted accrual quality as a measure, it has been noted that manipulations also play a role in determining the quality of earnings in actual activities. Researchers like Li and Quian (2011) and Liu, Harris, and Omar (2013) have shown the considerable effect of the remuneration committee on the level of CEO performamce pay.

Recent studies across the globe besides Africa ranging from Asia, Europe to Australia depicted varied association between corporate board remuneration and actual activities' financial re-engineering of reported earnings. While Naz, Hashmi and Ahmed (2024) emphasized how senior executives' financial styles, as measured by their manager-fixed effects and observable traits, have a big impact on choices about risk management of earnings, Allison, Cassiana and Rodrigo (2023) documented that when executives are partially or wholly compensated with plans of variable remuneration, the level of actual activities' financial re-engineering of reported earnings varies from that of executives who are paid entirely with plans of fixed remuneration. When the fraction of variable factors increases, high-level executives are also urged to raise their own level of actual activities' financial re-engineering; thus a positive relationship between corporate board remuneration and actual activities' financial re-engineering of reported earnings (Dias, Paiva and Carvalho, 2024). In contrast, Uddin (2024) moderating for the effect of Covid 19 reported that there exist a negative correlation between the compensation of CEOs (Corporate Board Remuneration attributes) and actual activities' financial re-engineering of reported earnings.

As recommended in the Nigerian code, having a majority of Independent Non-Executive Directors (INEDs) on the remuneration committee; who are to convene at least once annually, or as deemed necessary, to fulfill its responsibilities; it is believed that the Remuneration Committee(RC) can effectively and efficiently restrain actual activities' financial re-engineering provided that the independence and diligence of remuneration committee (RCIND and RCDIL) are not by any means infringed by the actions of the management. We therefore hypothesized that:

Ho_1: RC independence does not significantly predict actual activities' financial re-engineering.

Ho_2: RC meetings (diligence) do not significantly predict actual activities' financial re- engineering.

Ho_3: RC joint(combined) attributes(independence and diligence) do not significantly predict actual activities' financial re-engineering.

2.2 Actual activities' financial re-engineering (RAFRE)

Actual activities' financial re-engineering (RAFRE) as defined by Roychowdhury (2006) refers to the deviation from regular operational practices, driven by managers' intention to deceive certain stakeholders into believing that specific financial reporting objectives have been achieved through normal business activities. Roychowdhury (2006) relies on estimating actual activities' financial re-engineering in three possible areas, the production costs related to sales, the discretionary expenses, and cash flow from the operational process, then enforce a comprehensive measure for the RAFRE. Thus, Roychowdhury (2006) as mentioned in Alhadab (2012) devised a metric to assess the three forms of RAFRE that are often used by companies which were also focused on in this study:

a. **Sales Manipulation**: Increasing current-year sales by lowering prices and allowing more unrestricted credit sales. In the words of Alhadab (2012), "Accelerating sales will raise current-year profitability, but will diminish in subsequent years, resulting in decreasing cash flow". Managers may also take advantage of the flexibility of asset sales timing to boost reported profit to meet desired threshold when anticipating a decline in standard business practices (Efenyumi, 2023). According to Alhadab (2012), Specifically, Roychowdhury (2006) estimates the normal level of cash flows from operations using the following cross-sectional regression for each year and industry.

$$\frac{CFOit}{Ait-1} = \alpha_0 + \alpha_1\left(\frac{1}{Ait-1}\right) + \beta_1\left(\frac{S_{it}}{Ait-1}\right) + \beta_2\left(\frac{\Delta S_{it}}{Ait-1}\right) + \varepsilon_t$$

Abnormal cash flows for the firms is actual cash flows minus the normal level of cash flows calculated using the estimated coefficients from regression.

Where:

CFO_{it} : cash flows from operations for firm *i* at period *t*. All other variables are previously defined. (Alhadab, 2012)

b. **Overproduction:** Managers decide to generate an excessive amount of inventory in order to lower the cost of sold items. Increased production spreads fixed overhead costs across a larger number of commodities, increasing profits. The instinct is to overproduce in order to lower the cost per unit of commodities supplied over time. Roychowdhury (2006) estimates the normal level of COGS as linear function of contemporaneous sales using the following cross-sectional regression.

$$\frac{COGS_{it}}{A_{it}-1} = \alpha_0 + \alpha_1\left(\frac{1}{A_{it}-1}\right) + \beta_1\left(\frac{S_{it}}{A_{it}-1}\right) + \varepsilon_t$$

The normal level of inventory growth is estimated as follows,

$$\frac{\Delta INV_{it}}{A_{it}-1} = \alpha_0 + \alpha_1\left(\frac{1}{A_{it}-1}\right) + \beta_1\left(\frac{\Delta S_{it}}{A_{it}-1}\right) + \beta_2\left(\frac{\Delta S_{it-1}}{A_{it}-1}\right) + \varepsilon_{it}$$

Where:

ΔINV_{it}: change in inventory at the end of period t.

Production cost is thus defined as $PROD_{it} = COGS_{it} + \Delta INV_{it}$
while normal level of production cost is estimated as:

$$\frac{PROD_t}{A_t-1} = \alpha_0 + \alpha_1\left(\frac{1}{A_t-1}\right) + \beta_1\left(\frac{S_t}{A_{it}-1}\right) + \beta_2\left(\frac{\Delta S_t}{A_{it}-1}\right) + \beta_3\left(\frac{\Delta S_{t-1}}{A_{it}-1}\right) + \varepsilon_{it}$$

c. **Reducing Discretionary Spending**: Reducing R&D, advertising, and SG&A will boost current profitability. The reduction will have an impact on the company's performance, and future earnings may suffer as a result. Similarly, Roychowdhury (2006) estimates the normal level of the sum of discretionary expenses as a linear function of contemporaneous sales as follows,

$$\frac{DISEXP_{it}}{A_t-1} = \alpha_0 + \alpha_1\left(\frac{1}{A_t-1}\right) + \beta_1\left(\frac{S_{it}}{A_{it}-1}\right) + \varepsilon_{it}$$

However, Roychowdhury (2006) and Cohen *et al*. (2008) point out that estimating the normal level of discretionary expenses as specified in above regression will create a problem if firms manage sales upwards to increase reported earnings during any year. This problem will result unusually low residuals from running the regression as specified above. To overcome this problem, discretionary expenses are estimated as a function of lagged sales. Therefore, the normal level of discretionary expenses are estimated using a cross-sectional regression for each year and industry as follows,

$$\frac{DISEXPit}{At-1} = \alpha_0 + \alpha_1\left(\frac{1}{At-1}\right) + \beta_1\left(\frac{S_{it-1}}{Ait-1}\right) + \varepsilon_{it}$$

Abnormal level of discretionary expenses is actual discretionary expenses for the firms minus the normal level of discretionary expenses calculated using the estimated coefficients from regression (Cohen, Dey & Lys, 2008; Alhadab, 2012).

In summary, the RAFRE model this study is estimated in line with the Roychowdhury (2006) as cited in Alhadab (2012) and the Jeroh and Efenyumi (2022) model as a comprehensive metric that combines (ACFO* -1); the abnormal modules of cash flows from operating activities, (APROD); the abnormal modules of production costs, and (ADISEXP* -1); the abnormal modules of discretionary expenditures into a single proxy called RAFRE. This aggregate measure allows for a holistic assessment of these abnormal factors. Thus,

RAFRE = (ACFO* -1) plus APROD plus (ADISEXP* -1)

2.3 Theoretical Review

Agency theory provides the theoretical framework to explain the motives and reasons why reported earnings quality could be influenced because the focus is on investigating how specific key corporate governance mechanisms influence financial accounting issues associated with corporate management's behaviour that leads to determination of firms' earnings quality (Efenyumi, 2023).

The way businesses are run today, according to Soobaroyen and Ntim (2018), necessitated the developments of new code of corporate governance with improved mechanisms especially the introduction of RC, one of the board subcommittees are efforts aimed at aligning all parties' interests with a view to reducing agency costs; resulting from the contractual relationship between agent and principal under which shareholders delegate responsibilities to the manager to take charge of the business.

Efenyumi, Nwoye and Okoye (2022) asserted that from an agency perspective, BODs effective monitoring mechanisms are crucial in mitigating actual activities' financial re-engineering, and improve the quality of reported earnings. Agency theory sets the context for aligning the interests of all parties involved in governing the firm, and as such, properly designed BODs is of utmost importance in minimizing agency costs and any sort of closely connected private benefits that affect firm reported earnings.

2.4 Empirical Review

Few studies document the main role of the Remuneration Committee and found a positive relationship between this and firm performance. (Carter and Zamora; Kato, Kim and Lee cited in Borlea, Achim and Mare, 2017) but none to the best of my knowledge has examined the influence of corporate boards remuneration committee attributes on activities geared towards mitigate actual activities' financial re-engineering among listed companies in Nigeria.

Sequel to the dearth of previous researches to be reviewed in developing country Nigeria in particular, it became necessary for this study to assess how corporate boards remuneration committee attributes mitigate actual activities' financial re-engineering among listed companies in Nigeria.

3. Methods and Empirical Models

To analyze this data, an Ex-post facto research design was chosen. The research conducted in this study utilized secondary data obtained from annual reports of companies in Nigeria over a period of 11 years, from 2011 to 2021. A total of 814 firm-year observations were selected using judgmental sampling, which included 74 non-financial firms out of the total of 107 as of December 2021.

3.1 Variables Measurement

Table 1: Variables Description and Definition

Variables	Metrics	Label	Measurement
Dependent Variable	Actual activities' Financial Re-Engineering	**RAFRE**	Summation of Abnormal modules of cash flows from operating activities plus abnormal modules of production costs, plus abnormal modules of discretionary expenditures,

Independent Variables	Remuneration Committee Independence	**RCIND**	Percentage of independent directors in remuneration committees of firms
	Remuneration Committee Diligence	**RCDIL**	Number of times remuneration committees meet yearly
Control Variable	Growth Opportunity	**GRWOP**	sales in current year minus Sales for previous year divided by last year's sales

Authors Compilation, 2023

3.2 Empirical Models for Test of Hypotheses

The hypotheses were tested using linear models:

$RAFRE_{it} = \alpha_0 + \alpha_1 RCIND_{it} + \alpha_2 GRTOP_{it} + \varepsilon_t$ ....**Model 1**

$RAFRE_{it} = \alpha_0 + \alpha_1 RCDIL_{it} + \alpha_2 GRTOP_{it} + \varepsilon_t$ ....**Model 2**

$RAFRE_{it} = \alpha_0 + \alpha_1 RCIND_{it} + \alpha_2 RCDIL_{it} + \alpha_3 GRTOP_{it} + \varepsilon_t$ ....**Model 3**

4. Analysis, Result and Discussion

4.1 Descriptive Statistics

Table 2: Descriptive Statistics Results

Variables	Obs	Avrg Val	Stnd Dvtn	Min Val.	Max Val.
RAFRE	814	0.004741	0.399911	-4.3295	1.83915
RCIND	814	0.404093	0.461938	0	1
RCDIL	814	1.055283	1.055368	0	9
GRWOP	814	7.738549	13.89925	-9.9750	49.0209

Stata-13 Regression Output, 2023

The summary of descriptive statistics of the study is reflected in table 2 above. There were 814 observations for all of the variables; no missing data for any year as shown above; ensuing in a strongly balanced panel data set. The variables (RAFRE, RCIND, RCDIL and GRWOP) have recorded means of 0.004741, 0.404093, 1.055283 and 7.738549 respectively. These variables' low values and their corresponding standard deviations centred around their means with very minimal variances are pointing to the fact that the data for the study may have followed a normal curve; except the stnd dvtn of 13.89925 for the Growth Opportunity (GRWOP) which, on average, is not a very high standard deviation.

Table 2 results apparently revealed that variables' minimum values ranged from about -9.9750 (GRWOP) to 0 (RCIND and RCDIL), Having 0 as the minimal value of RCIND and RCDIL signifies that there are companies without Independent directors on Remuneration Committees (RC) of their Boards in specific years coupled with numerous instances of RC of their Boards not having meetings during the study period. The minimum value of zero (0) for RCIND and RCDIL further revealed that the minimum level of independent directors as recommended by the NCCG (2018) as amended; for the optimum performance of the Remuneration Committee of Corporate Boards of some of the sampled companies is not met hence no meetings, further proving that some of the sampled companies operates without the presence of independent non-executive directors and non-executive directors in their Boards.

4.2 Correlation Analysis

Table 3: Correlation Matrix

VARIABLES	RAFRE	RCIND	RCDIL	GRWOP
RAFRE	1.0000			
RCIND	-0.1321	1.0000		
RCDIL	-0.1054	0.7390	1.0000	
GRWOP	-0.1485	-0.0099	0.0175	1.0000

Stata-13 Regression Output, 2023

Statistics from the correlation matrix reveals that all the variables had negative coefficients for RAFRE implying that; a rise of one unit in RCIND, RCDIL and GRWOP will probably cause RAFRE to fall by 0.1321, 0.1054 and 0.1485 units, respectively. Since all pairs of explanatory variables' coefficients are below the upper limit of 0.80; we affirm that the data set is free from multicollinearity issues having observed that the pair of independent variables with the highest correlation coefficient was RCDIL and RCIND (0.7390).

4.3 Collinearity Test

Table 4: Collinearity Test Results

VARIABLES	RCIND	RCDIL	GRWOP	Mean VIF
VIF	2.21	2.21	1.00	1.80
1/VIF	0.4532	0.4533	0.9985	

Stata-13 Regression Output, 2023

The above test results from the VIF table as shown produces VIF levels from 1.00 (GRWOP) to 2.21 (RCIND & RCDIL). With the maximum degree of tolerance being 0.9985 (for GRWOP); whereas the mean VIF was 1.80, we reaffirm that the data for this study do not exhibit evidence of multicollinearity since the mean VIF was under the critical Value of 10, which is consistent with earlier empirical documentations.

4.4 Hypotheses Analysis and Discussion

Table 5: Regression Results for Test of Hypotheses

Dependent Variable = Actual activities' financial re-engineering (RAFRE)			
Independent Variable	**[Model 1] Hypothesis 1**	**[Model 2] Hypothesis 2**	**[Model 3] Hypothesis 3**
C	0.0603235**	-0.0413466*	0.0604273**
	(0.001)	(0.014)	(0.001)
RCIND	-0.1156314**		-0.1098760*
	(0.000)		(0.013)
RCDIL		-0.0264701**	-0.0023147
		(0.003)	(0.860)
GRWOP	-0.0007688**	-0.0007528**	-0.0007677**
	(0.000)	(0.000)	(0.000)
OBS	814	814	814
R^2	0.0399	0.0326	0.0399
F-Stat	16.84**	13.67**	11.23**
Prob > F	(0.0000)	(0.0000)	(0.0000)

Stata-13 Regression Output, 2023. *significant at 5%; **significant at 1%;

Table 5 presents the postulated hypotheses results. The result for Model I which tests hypothesis I displays that Remuneration Committee independence (RCIND) and the control variable, revenue growth opportunity (GRWOP) exhibits negative association with actual activities' financial re-engineering (RAFRE). Thus, as GRWOP and the level of RCIND grow in magnitude, the tendencies of firms engaging in real financial re-engineering activities reduce. The p-value of 0.000 shows that at 1% significance level, RCIND exert significant influence on RAFRE. Correspondingly, F-stat which is at 16.84 (with p-value at 0.0000), implies that Remuneration Committee independence exerts significant influence on actual activities' financial re-engineering. Founded on this result, we therefore reject hypothesis I and conclude that Remuneration Committee independence significantly predicts actual activities' financial re-engineering of companies in Nigeria.

As regards Model II in Table 5, the outcome discloses that both RCDIL and GRWOP recorded negative regression coefficients of -0.0264701, and -0.0007528 respectively; evincing that as the revenue level expands alongside frequency of RC meetings, actual activities' financial re-engineering tend to diminish in magnitude. The p-value of 0.003 shows that at 1% significance level, RCDIL exert significant influence on RAFRE. Likewise, the F-stat value which is 13.67 (with p-value which stood at 0.0000), points to the fact that Remuneration Committee frequent meetings/diligence exerts significant influence on actual activities' financial re-engineering and this result is significant at 1%. Building on this outcome, we therefore reject hypothesis II and conclude that diligence as attribute of the Remuneration Committee significantly predict the level of engagement of Companies in Nigeria in the activities of real financial re-engineering.

Furthermore, from the outcome for the test of hypotheses III, we found that our result was consistent with the results of Hypothesis I and II, where RCIND, RCDIL and GRWOP recorded negative regression coefficients of -0.1098760, -0.0023147, and - 0.0007677 respectively which evidently reported that as the level of RC independence expands alongside growth in revenue levels and increase in the number of RC meetings/diligence, the magnitude of RAFRE shrinks; thus signifying that an increase in independence and diligence as well as growth in revenue will result to lower levels of actual activities re-engineering.

Obviously, the p-values for RCIND, RCDIL and GRWOP which were 0.013, 0.860 and 0.000 shows that at 5% and 1% significance level, RC independence and revenue growth opportunity respectively exert significant negative influence on RAFRE while RC diligence exert very insignificant negative influence on RAFRE. Nevertheless, our computed value of F-stat which is 11.23 with a 0.0000 as its corresponding p-value which strongly suggests that the corporate boards' remuneration committee attributes/variables jointly exerts significant influence on RAFRE as shown in Model III result. Sequel to this outcome, we therefore reject hypothesis III and conclude that RC attributes significantly mitigate the activities of real financial re-engineering of companies in Nigeria.

Conclusion

This paper explores empirical evidence in explaining and predicting the statistical link between the attributes of remuneration committees of companies' boards and actual activities' financial re-engineering. Relying on 11 year data for 74 sampled companies giving 814 company-to-year observations between 2011 and 2021, we found that corporate boards' remuneration committee attributes/variables jointly exerts significant influence on actual activities' financial re-engineering (RAFRE) and finally, we document that an increase in the level of RC attributes (independence and/or diligence) will significantly mitigate the activities of real financial re-engineering of companies in Nigeria.

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