

# Firm Attributes and Earnings Quality of listed Oil and Gas Companies in Nigeria

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## Abstract

This paper is an empirical investigation of firm attributes and earnings quality of listed oil and gas companies in Nigeria for the period of 2007-2011. The listed Oil and Gas firms are Nine (9) in numbers out of which a sample of Seven (7) were used for the study. Firm attributes as the independent variable was proxy with firm size, leverage, Institutional ownership, profitability, liquidity and firm growth), While the residuals from the modified Jones model by Dechow et al (1995) was used to proxy earnings quality. The study adopts multiple panel regression techniques and data were collected from secondary source through the annual reports and accounts of the firms. The findings reveal that leverage, liquidity and firm growth has a significant positive impact on earnings quality while firm size, institutional ownership and profitability have a significant but negative influence on earnings quality of listed oil and gas companies in Nigeria. It is recommended among others that the oil and gas companies may choose to go for more debt especially where the interest rate is considerably low and also increase their liquidity asset and turnover as it has been found empirically to enhance the quality of the firms reported earnings.

**Keywords:** Firm Attributes, Earnings Quality and Oil and Gas Companies

## 1.1 INTRODUCTION

The Global financial crises, corporate failures and scandals around the world and specifically the recent discovery by the Central Bank of Nigeria in the Banking sector has raise a serious questions about the relevance, reliability and effectiveness of the reported accounting earnings. Reported accounting information is said to be relevant to the degree of its capability of influencing a decision maker by helping him/her to form predictions about the outcomes of present event or to confirm or correct prior expectations (Bushman, Chen, Engel and Smith, 2004) as cited in Shehu (2012). While reliability deals with the quality of reported earnings which is said to be free of error, bias and faithfully represent it is actual intended representation. But however, we are left with the question of the possibility of having the annual reports and accounts totally free of bias even if the reports and accounts are totally free of errors. This is humanly impossible because the regulatory inconsistency and the choices available to managers in accounting policies has often call for the exercise of judgments or opinion in preparing the annual reports and accounts which may eventually mislead the public in taken certain decisions with respect to the information made available by the management which is mostly aimed at communicating self-serving information. Therefore for accounting information to be heavily relied upon by the public and to be regarded a quality type; it must be neutral, timely, relevant, accurate, transparent, comparable, predictive, understandable, verifiable and unambiguous in its entirety.

There are several reasons that have been attributed to the preparation of misleading financial statements which may ranges from the demand for higher returns by shareholders on their investments, the quest to maintain a giant corporate status in the eye of the business community or sporadic changes in competitiveness, the craze to satisfy the greed of company's insiders (Shehu, 2012). The consistent failure by Nigerian Corporate Governance culture to be pro-active, active, responsible and accountable to the stakeholders can be attributed to the lackadaisical nature of the regulatory agencies that has left the issue of earnings management under the disguise of business ethics.

Firm attributes is said to have significant role in explaining firm level earnings quality. Firm attributes are referred to as those incentive variables that relatively sticky at firms' level across time. They are variables that affect the firm's decision both internally and externally (Shehu, 2012). The incentive variable ranges from ownership structures, firm size, leverage, profitability, Liquidity, firm growth among others.

In view of the fact that Firm attributes plays an astute role in restraining account information preparers (managers) from maneuvering the accounting figures which will eventually enhance the quality of reported accounting earnings. To this end, there have been inconclusive findings and divergent view in extant literatures as to whether Firm attributes have effect on earnings quality. To the best of our knowledge no research of this nature has been conducted in the Oil and Gas sector, therefore the study seek investigates the influence of Firm

attributes on earnings quality of listed Oil and Gas firms in Nigeria.

### Objectives of the Study

The major objective of the study is to determine the degree to which Firm attributes influences the Earnings quality of listed Oil and Gas firms in Nigeria. Hence, the following individual objectives are highlighted below:

- i. To examine the impact of Firm size on Earnings Quality of Listed Oil and Gas firms in Nigeria;
- ii. To investigate the influence of Leverage on Earnings Quality of Listed Oil and Gas firms in Nigeria;
- iii. To ascertain the effect of Institutional Ownership on Earnings Quality of Listed Oil and Gas firms in Nigeria;
- iv. To determine the contribution of Profitability on Earnings Quality of Listed Oil and Gas firms in Nigeria;
- v. To study the bearing of Liquidity on Earnings Quality of Listed Oil and Gas firms in Nigeria;
- vi. To find the impact of Firm Growth on Earnings Quality of Listed Oil and Gas firms in Nigeria;

In view of the above objectives, the following null hypotheses have been formulated in null form.

- Ho1 Firm size has no significant impact on Earnings Quality of listed Oil and Gas firms in Nigeria  
Ho2 Leverage has no significant influence on Earnings Quality of listed Oil and Gas firms in Nigeria  
Ho3 Institutional Ownership has no significant effect on Earnings Quality of listed Oil and Gas firms in Nigeria  
Ho4 Profitability has no significant contribution on Earnings Quality of listed Oil and Gas firms in Nigeria  
Ho5 Liquidity has no significant bearing on Earnings Quality of listed Oil and Gas firms in Nigeria  
Ho6 Firm Growth has no significant impact on Earnings Quality of listed Oil and Gas firms in Nigeria

The Nigerian Oil and Gas sector plays a vital role in the economy as there is heavy reliance from the income that is generated from the sector in transforming and developing the country, therefore there is need to give a close monitoring to their reported earnings and their practice of corporate governance in entirety. Also a study of this nature will in doubt serve as a guide to managers, government, regulators, investors and potential investors in looking out for these Firm attributes that positively enhances the quality of reported earnings. Additional it will assist the standard setters in adjusting and determining the optimum level of management discretion and opinion to ensure they communicate information which is hinge on the underlying economic performance of the firms.

In order to achieve the objective of the research work, this paper is organized into five sections, with this section being the Introduction. Section 2 handles the review of relevant literatures. Section 3 is devoted to the methodology of the study. Section 4 present and discuss the result of the data. Section 5 ends the study by giving more emphasis on the findings and the policy implications of the study.

## 2.1 THEORY AND EVIDENCE

Firm size is measured as the natural logarithm of total asset as used by Shehu, 2012, Chen et 'al 2005, Ghazali, 2010, Hasan and Ahmed, 2012). It used in their study to examine the impact of size on earnings management and financial reporting quality. There is lots of argument that the larger firm size , the higher the expected agency problem that organizations may likely face. In the works of Ahmed and Courtis (1999) as cited in Shehu, (2012), they identify theoretical argument linked to firm size , such as agency costs, political costs, signaling and information asymmetry, capital needs, litigation cost and audit firm reputation.

Dwi Lusi (2013) in his paper found that larger firm size is associated and has negative impact on earnings management of listed food and beverages companies in Indonesia. This result implies that the higher the firm size , the lower the earnings is manipulated and hence the higher the quality of reported earnings. The study of Naser et 'al, (2002), Glaum and Street, (2003), Akhtaruddin (2005) as cited in Shehu (2012) also found a negative relations between size and Financial Reporting Quality. Hashem et 'al (2012) found positive and significant relationship between size and earnings management which implies that the reported earnings quality is low. In the same vein, Adelopo, (2010) also found a significant positive relationship between voluntary disclosure and firm size. On the other hand Nelson and George, (2013) found no significant relationship between firm size and earnings management and thus the quality of the reported earnings is not at question. McNally et 'al (1982) examine the quality of financial reports with corporate characteristics and found that the only significant independent variable among the corporate characteristic used in the study was between firm size and information quality

Leverage has been seen as one of the most vital Firm attributes to have influence on the earnings quality of firms, the research conducted by Shehu, (2009) shows that leverage is positively related to financial reporting quality. Similar to the finding is the study conducted by Naser (1998), Tower et 'al, (1999), Wallace et 'al, (1994), Wallace and Naser, (1995), Mangena et 'al, (2007), Yang and Krishnan, (2005) as cited in Shehu, (2012). On the other hand, the study conducted by Hashem et 'al (2012) found positive and significant relationship between debt ratio and earnings management which implies that the reported earnings quality is low.

In the same vein, Nelson and George, (2013) found a significant positive relationship between leverage and earnings management. Their result is said to have been consistent with signaling theory, because highly leveraged companies would engage in earnings management in a bid to have reports that will enable them attract more capital at reasonable rate, thus the quality of the report is trampled upon.

Institution that has shares in an organization has the expertise, resource and the technical know-how to monitor the activities of the management. Most researchers have found significant impact of proportions of shares held by institutions on the earnings quality of firms. The study conducted by Shehu, (2009) revealed that institutional ownership has a positive and significant impact on financial reporting quality. Also, in the works of Healy et al (1999), Chung et al (2005), Bushee and Noe, (2000) shows that increase in disclosure and quality of reported earnings is associated with an increase in institutional investors' ownership. While on one hand the study of Jacobs, (1991), Ajinkya et al, (2005), Potter, (1992), Koh and Hsu, (2003), Greaves and Waddock, (1990) all found a negative association between Institutional ownership and earnings quality of firms. They argue that this may be as a result of the fact that institutional investors tend to discourage managers from investing in long term projects and focus on projects with short term pay offs especially when the institutions themselves are judged by their own short-term portfolio performance. To this end managers are forced to engage in earnings manipulation and as a result the quality of reported earnings lack reliability.

Profitability is one of the firm attributes also identified to have great influence on the earnings quality of firms. The works of Hashem et al (2012) shows that Return on asset used as proxy for performance of firms is significantly positively related to earnings management, which indicates that when there is any increase on performance of firms, there will be a corresponding increase in earnings manipulation and as a result of this, the quality of the earnings reported is at jeopardy. In line with this, is the studies conducted by Davidson, Stewart and Kent, (2005), Klein (2002b) also have similar findings which they argued that changes in profit influences the manipulation of accounting accruals especially when they are low. Thus the earnings quality of such firms is low. On one hand the works of Nelson and George, (2013), Alsaeed, (2006), Haniffa and Cooke, (2002) found no significant relationship between firm performance and earnings management and voluntary disclosure and thus performance has no any impact on the quality of reported earnings.

Liquidity has been argued over the years to a brain box for survival of a business, because businesses that are facing problem of liquidity may be heading towards crises and as such a reasonable part of asset is expected to be held in liquid form in order to meet day to day activities of the business. Any organization that is liquid may be willing to disclose that in their financial reports in order to attract their creditors, increase their ability of raising fund externally to finance future projects. Also it is an indication to regulators, investors, potential investors and other stakeholders that the business the ability of existing for a foreseeable future without any financial hitches. Such firms will be willing to make public through disclosure their level of liquidity.

Firm growth in extant literature has mixed findings as regards its relationship with earnings quality. Any growing Firm is billed to have less sustainable earnings as posited by (Nissim and Penman, (2000). Some argued that, a growing firm will want to maintain that trend and as such engage in earnings smoothing which reduces the quality of the reported earnings. Some may be due to pressure to meet earnings benchmark. While some growing that experience decline in growth may still want to report it as it is because they are aware manipulating such earnings just to portray good health of the business may spell doom for the firm in the long-run especially when the firm is not under any pressure to meet earnings benchmark. Beaver et al, (1968) research shows that growth opportunities provides managers with incentive to smooth earnings as earnings volatility increase perceived firm risk which adversely affect the cost of capital needed by the firm. In line with this is the study of Pincus and Rajgopal, (2002), Firth et al (2007), Young, (1999)

Many theories have been used in the literatures to underpin research of relationship between firm attributes and earnings quality. Some of those theories are, contracting theory advocated by Bowen, Rajagopal and Venkatachalan, (2008), the opportunist theory advocated by Klein, (2002), and Agency theory. The study therefore adopts the three theories to underpin this research work since the three theories are linked with positive association between firm attributes used and earnings quality.

### **3.1 METHODOLOGY AND MODEL SPECIFICATION**

This study adopts the Correlational and Ex-post factor design. This is because the research is aimed at investigating the impact of Firm attributes on Earnings Quality. The data were obtained from secondary sources through the firm's audited annual reports and accounts. The population of the study consists of the nine (9) listed Oil and Gas firms in Nigeria as at 31st December 2011, while the sample size is Seven (7). The study used censoring sampling techniques which is based on the availability of data; thereby leaving Beco Petroleum Product Plc and Afroil Plc. Multiple regression techniques was used for the analysis through the use of SPSS. This is because the research is highly descriptive and empirical as it embraces the use regression analysis where Ordinary Least Square Technique is employed.

#### **3.2 Model Specification:**

In bid to ascertain the influence of Firm attributes on Earnings Quality of listed Oil and Gas firms in Nigeria, a multiple linear model is built. The model encapsulates the contribution of Firm size , Leverage, Institutional Ownership, Profitability, Liquidity and Firm Growth on Earnings Quality

$$EQL_{it} = \alpha + \beta_1 FSIZE_{it} + \beta_2 LEVR_{it} + \beta_3 ISTOW_{it} + \beta_4 PROFIT_{it} + \beta_5 LIQD_{it} + \beta_6 FGRWTH_{it} + \epsilon$$

Where EQL is the residuals from the regression of modified Jones Model by Dechow et' al (1995)

FSIZE: Firm size measured as natural log of total asset

LEVR: Leverage measured as the ratio of total debt to equity

ISTOW: Institutional Ownership measured as proportion of shares held by institutions

PROFT: Profitability measured as the ratio of profit after tax to total asset

LIQD: Liquidity measured as the ratio of current asset to current liability

FGRWTH: Firm Growth measured as changes in sales

$\alpha$  is constant

$\beta_1 - \beta_6$  are the coefficient of the parameter estimate.

$\epsilon$  is the error term.

#### 4.1 RESULT AND DISCUSSIONS

This section presents the result of data analysis and tests of hypotheses formulated earlier in the paper. First, descriptive statistics, followed by the correlation matrix table and then the summary of Regression Result are presented and analyzed, and then policy implications and Recommendation will be made.

Table 4.1: Descriptive Statistics

Variable	Min	Max	Mean	Std. Dev.
EQL	0.00001	0.00030	0.0001526	0.00008025
LN_FSIZE	20.39	24.78	22.9096	1.02923
LEVR	0.20	0.99	0.7866	0.21838
ISTOW	34.51	74.50	61.6480	11.73878
PROFT	0.01	0.77	0.3386	0.22425
LIQD	0.65	5.24	1.2714	0.75753
FGRWTH	4E+009	2E+011	8E+010	6.019E+010

Source: SPSS output

From Table 4.1 above, the mean value for Earnings Quality is 0.0002 for firms, while Firm size , Leverage were having an average value of 22.91 and 0.79 respectively. Institutional Ownership has an average value of 61.64, while Profitability, Liquidity and Firm Growth have an average value of 0.34, 1.27 and 8E+010. The 79% average value for leverage indicates that the firm's capital is majorly financed from debt while the remaining 21% is funded using Equity. The minimum value for Earnings Quality is 0.00001 and the maximum value is 0.00030, both indicating a higher quality of earnings. It is however observed that the Institutional ownership has the highest standard deviation among the independent variables and therefore it shows that the institutional ownership has the lowest contribution to the endogenous variable (EQL).

#### The Correlation Matrix Table

The table below shows the correlation values between the dependent variable and the independent variables and also the association between the independent variables themselves. The values were extracted from the Pearson correlation of two-tailed significance.

Table 4.2: Correlation Matrix

Variable	EQL	FSIZE	LEVR	ISTOW	PROFT	LIQD	FGRWTH
EQL	1						
FSIZE	-0.185	1					
LEVR	-0.107	0.231	1				
ISTOW	-0.465	0.455	0.526	1			
PROFT	0.023	-0.610	0.259	-0.205	1		
LIQD	0.120	0.434	-0.021	0.070	-0.440	1	
FGRWTH	0.147	0.069	0.215	0.424	0.228	-0.302	1

Source: SPSS output

Table 4.2 above shows that three of the independent variables (FSIZE, LEVR, ISTOW) are negatively related to Earnings Quality of listed Oil and Gas firms in Nigeria, while the remaining three independent variables (PROFT, LIQD, FGRWTH) were positively related to Earnings quality of listed Oil and Gas firms in Nigeria. All of these variables were insignificantly related except for Institutional ownership that is significant at 1%. Amongst the independent variables, the relationship was a very weak one as expected except for only four of the

independent variables that were significantly related which may not pose any colinearity problem. Five amongst the independent variables were negatively related while ten of the explanatory variables were positively related. The tolerance values and the variance inflation factor are two good measures of assessing multicollinearity between the independent variables in a study. The result shows that variance inflation factor were consistently smaller than ten (10) indicating complete absence of multicollinearity (e.g Neter et al; 1996 and Cassey et al; 1999). This shows the suitability of the study model been fit with the six independent variables. Also, the tolerance values were consistently smaller than 1.00, therefore extend the fact that there is complete absence of multicollinearity between the independent variables (Tobachmel and Fidell, 1996).

### The regression result

This table presents the regression result of the dependent variable (CSR) and the independent variables of the study (FSIZE, LEVR, ISTOW, PROFT, LIQD and FGRWTH). The presentation follows the analysis of the association and impact between the independent variables and the dependent variable of the study and also the cumulative analysis.

$$EQLit = \alpha + \beta_1FSIZEit + \beta_2LEVRit + \beta_3ISTOWit + \beta_3PROFTit + \beta_3LIQDit + \beta_3FGRWTHit + \epsilon$$

Table 4.3: Summary of Regression Result

Variable	Coefficient	t-values	P-values	Tolerance	VIF
Constant	0.001	3.386	0.002		
FSIZE	-3.0E-005	-2.128	0.042	0.407	2.458
LEVR	0.000	3.022	0.005	0.483	2.070
ISTOW	-6.8E-006	-5.698	0.000	0.445	2.249
PROFT	0.000	-2.927	0.007	0.365	2.742
LIQD	3.58E-005	2.396	0.023	0.687	1.455
FGRWTH	9.60E-016	4.845	0.000	0.620	1.613
R					0.785
R2					0.616
Adj R2					0.534
F-Stat.					7.497
F-Sig					0.000
D/W					1.286

Source: SPSS output

The cumulative correlation between the dependent variable and all the independent variables is 0.785 indicating that the relationship between Earnings Quality and Firm attributes used in the study is 79% which is strongly, positively and statistically significant. This means that for any changes in Firm attributes of listed Oil and Gas firms in Nigeria; their Earnings Quality will be affected directly.

The cumulative R2 (0.616) which is the multiple coefficient of determination gives the proportion of the total variation in the dependent variable explained by the independent variables jointly. Hence, it signifies 62% of the total variation in Earnings Quality of listed Oil and Gas firms in Nigeria is caused by their Firm size, Leverage, Institutional Ownership, Profitability, Liquidity and Firm Growth. This indicates that the model of the study of the study is fit and the independent variables are properly selected, combined and used. The Durbin Watson tests of first order auto-correlation which have a value of 1.286 indicates that indicate that serial correlation is not a problem as it falls within the lower limit and upper limit of Table D.5B of Durbin-Watson statistic table of 1% level of significance as cited in Gujarati (2004).

### Firm size and Earnings Quality

From the table 4.3 above, Firm size has a t-value of -2.128 and a beta value of -3.0 which is significant at 5%. This signifies that Firm size is strongly, negatively and significantly influencing Earnings Quality of listed Oil and Gas firms in Nigeria. It implies that for every one Naira (N1) increase in total asset of the firms, the Earnings Quality will decrease by N3.00. This may be as a result of the fact that large firms are visible and susceptible to political attacks, in the form of pressure for the exercise of social responsibilities, greater regulation such as price control and higher corporate taxes which may make firms react by avoiding attention which disclosure of some significant facts could have brought to them (Wallace et al 1994; Wallace and Naser, 1995) as cited in Shehu, (2012). This provides an evidence of rejecting null hypothesis one of the study which states that Firm size has no significant impact on Earnings Quality.

### Leverage and Earnings Quality

From the table 4.3 above, Leverage has a t-value of 3.022 and a beta value of 0.000 which is significant at 1%. This signifies that Leverage is strongly, positively and significantly influencing Earnings Quality of listed Oil



and Gas firms in Nigeria. It therefore implies that for every one Naira increase (N1) in debt, the Earnings Quality will increase by N0.00. This may be as a result of the fact that as leverage increases, there are wealth transfer from fixed claimant to residual claimants as such debenture holders are able to 'price protect' themselves, managers and shareholders have incentive to voluntarily increase the level of monitoring, such as by increasing the disclosure of additional information about the firms activities (Schipper, 1981) as cited in Shehu, (2012). This provides an evidence of rejecting null hypothesis two of the study which states that Leverage has no significant impact on Earnings Quality.

#### **Institutional Ownership and Earnings Quality**

From the table 4.3 above, Institutional Ownership has a t-value of -5.698 and a beta value of -6.8 which is significant at 1%. This signifies that Institutional Ownership is strongly, positively, and significantly influencing Earnings Quality of listed Oil and Gas firms in Nigeria. It therefore implies that for every one percent (1%) increase in shares held by Institutions, the Earnings Quality will decrease by N6.8. This may be as a result of the fact that some institutional investors encourage corporate managers to focus on short-term profit and also because they are likely to sell their holding in poorly performing firms, managers may be forced to smooth their earnings in order to maintain their institutional investors which is at the expense of the quality of their reported earnings. This provides an evidence of rejecting null hypothesis three of the study which states that Institutional Ownership has no significant impact on Earnings Quality.

#### **Profitability and Earnings Quality**

From the table 4.3 above, Profitability has a t-value of -2.927 and a beta value of 0.000 which is significant at 1%. This signifies that Profitability is strongly, negatively, and significantly contributing to Earnings Quality of listed Oil and Gas firms in Nigeria. It therefore implies that for every one Naira (N1) increase in Profitability of listed Oil and Gas firms, the Earnings Quality will decrease by N0.000. This may be as a result of the fact that managers may manage earnings to increase their bonus rewards. Therefore as the manager increases the profit of the firm through smoothing, the quality of the reports is trampled upon. This provides an evidence of rejecting null hypothesis four of the study which states that Institutional Ownership has no significant impact on Corporate Social Responsibility.

#### **Liquidity and Earnings Quality**

From the table 4.3 above, Leverage has a t-value of 2.396 and a beta value of 3.58 which is significant at 5%. This signifies that Liquidity is positively, strongly and significantly influencing the Earnings Quality of listed Oil and Gas firms in Nigeria. It therefore implies that for every one Naira (N1) increase in Liquidity of listed Oil and Gas firms, the Earnings Quality will increase by Three Naira, Fifty-eight Kobo (N3.58). This may be as a result of the fact that maintaining higher liquidity is of great concern to regulators, investors and others users of financial statements with regards to the going concern of the business and its ability to meet up with its current obligations. Therefore highly liquid firms may desire to make public through disclosure in their annual reports and accounts the level of their liquidity which will eventually enhance the quality of their reported earnings. This provides an evidence of rejecting null hypothesis five of the study which states that Liquidity has no significant influence on Earnings Quality.

#### **Firm Growth and Earnings Quality**

From the table 4.3 above, Firm Growth has a t-value of 4.845 and a beta value of 9.60 which is significant at 1%. This signifies that Firm Growth is positively, strongly and significantly impacting on Earnings Quality of listed Oil and Gas firms in Nigeria. It therefore implies that for every one Naira (N1) increase in sales value of listed Oil and Gas firms, the Earnings Quality will increase by Nine Naira, Sixty Kobo (N9.60). This may be as a result of the fact that firms with consistent increase in growth may not be under any pressure meet earnings benchmarks by engage in earnings manipulations. Hence the quality of earnings reports is assured. This provides an evidence of rejecting null hypothesis six of the study which states that Firm Growth has no significant impact on Earnings Quality.

### **5.1 CONCLUSIONS AND RECOMMENDATIONS**

The paper investigates the influence of Firm attributes on Earnings Quality of listed Oil and Gas firms in Nigeria. The firm size, Leverage, Institutional ownership, Profitability, Liquidity and Firm growth constitute firm characteristics, while the residuals from the modified Jones Model by Dechow et al (1995) was used to proxy Earnings Quality which represent the dependent variable of the study. It was found that Leverage; Liquidity, and Firm Growth have a positive and significant influence on Earnings Quality of listed Oil and Gas firms, while Firm size, Profitability and Liquidity has negative and significant impact on Earnings Quality of listed Oil and Gas firms in Nigeria. Therefore the result implies that Firm attributes has strongly and

significantly impacted on the Earnings Quality of listed Oil and Gas firms in Nigeria. It is recommended that the Oil and Gas firms may choose to go for more debt especially where the interest rate is considerably low and also increase their liquidity asset and turnover as it has been found empirically to enhance the quality of firms reported earnings. Also precautionary measures should be taken over firm size, proportion of shares held by institutions, and also pursuance of higher profit at the expense of the quality of reported earnings. This could be achieved through less regulation such as price control and reduced corporate tax in order for firms to disclose more detailed information in their annual reports and accounts.

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