

## INCOME SMOOTHNESS AND FINANCIAL REPORTING QUALITY OF LISTED INSURANCE COMPANIES IN NIGERIA

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### ABSTRACT

*The study examined income smoothness and financial reporting quality of listed insurance companies in Nigeria. The specific objectives are; examine the relationship between income smoothness and faithful representation of listed insurance companies in Nigeria, evaluate the relationship between income smoothness and relevance of listed insurance companies in Nigeria and investigate the effect of firm size on the relationship between income smoothness and quality of financial reporting in listed insurance companies in Nigeria. The expo facto designs. The population of the study was the twenty-five (25) listed insurance companies in the Nigerian Stock Exchange during the period 2013 -2019 (7) years. The sample size of this study is twenty-one (21). This number is derived by the application or use of Taro Yamane formula for sample size determination. Out of the twenty-four (24) companies, three (3) companies have incomplete financial statements which leave the sample size to be twenty-one (21) listed insurance companies. The study employed the use of secondary data. The formulated research questions were analyzed with descriptive statistics. The hypotheses were tested using the simple regression analysis with the aid of E-view (10). The findings of the study were that there is insignificant relationship between income smoothness and faithful representation of listed insurance companies in Nigeria. There is insignificant relationship between income smoothness and relevance of insurance companies in Nigeria. There is significant influence of firm size in the relationship between income smoothness and quality of financial reporting in listed insurance companies in Nigeria. The study recommend that insurance companies should reduce the rate of income smoothness to enhance the credibility and financial reports quality. Regulators should not mainly rely on accounting numbers to govern the listed insurance firms, but should make sure they strictly abide by the rules, regulations, and ethics of international standards governing the preparation and presentation of financial reporting in order to avoid continuous smoothing of income and presenting falsified financial statements. The peer review mechanism of audit committees in the industry should be encouraged and implemented vigorously and be used as a platform to set benchmarks for effective monitoring.*

**Keywords; Financial Reporting Quality, Income Smoothness, Faithful Representation, Relevance and Firm Size**

### INTRODUCTION

Investors basically make more informed investment decisions based on the information acquired in the reports. Idyllically, the reported earnings should reflect a company's underlying operating economics and simplify efficient resource allocation within the company. Nonetheless, given the control advantages that managers have in reporting and collecting firm-specific information over external information users, managers have the opportunity to present the company's earnings in a manner that is most suitable for the company or for themselves. Commonly known as earnings smoothing are a method of managing their earnings, this topic is of considerable interest to academics and practitioners (Hatam, 2013).

The term income smoothing refers to changing expenses and revenue to give the impression that a firm's earnings are stable. As stated by Guillaume and Pierre (2016), income smoothing is a technique used in incentive accounting to smooth out fluctuations in business earnings.

Martinez-Ferrero (2015), financial reporting quality as the accuracy of the financial reporting process's information. Relevant information means that the financial statement contains enough information to help different users make decisions, and that the information is provided while it is still "news". Reliability ensures that data is free of errors and biases and accurately represents what it is intended to represent. A financial report's data is reliable if it can be used to assess the economic conditions or events it represents (Shehu, 2013). A transparent figure accurately reflects an organization's economic activity during the period. The figures are presented with clarity. Presentation style and language are also vital. Investors, creditors, and other users should be able to project future cash flows using financial reporting (Waweru & Riro, 2013).

Nigeria's financial information quality lags behind many advanced jurisdictions. This has hampered efficient equity market growth. Investors in Nigeria frequently complain that financial information on company performance is either unavailable or unreliable (Shehu, 2011). Nigerian analysts are far fewer than in developed markets. The Nigerian market is thus argued to be less regulated than developed markets. Aside from that, the Nigerian environment is expected to be unique in terms of accounting standards, institutional structure, and corporate governance. A comprehensive study anchoring income smoothness and financial reporting quality is needed and will be of interest to investors given these assumptions (Holland & Ramsay, 2013). The study may help auditors and financial information users understand the importance of proper income smoothness positioning. It will help clients understand the firm's characteristics and how they affect financial reporting quality. The Financial Reporting Council of Nigeria, the Nigerian Securities and Exchange Commission, and the Corporate Affairs Commission are among the regulators tasked with regulating manipulative accounting and ensuring high quality financial reporting. This research's findings will also benefit financial analysts, stock market participants, shareholders, and management of Nigerian financial firms.

### **Statement of Problem**

Earnings smoothing is common in Nigerian listed companies. For example, the Nigeria Securities Regulatory Commission (NSRC) requires listed companies to have a certain return on equity (ROE) before allowing them to issue new shares to existing shareholders (rights issues). One peculiarity of Nigerian listed companies is that some are in financial distress and should have been bankrupt by developed country standards. But they are still listed in Nigeria stock exchange (Uwalomwa et al. 2016). As a result, Nigeria's financial information quality lags behind many advanced jurisdictions. Due to firm's earnings smoothing, investors in Nigeria frequently complain about the lack of or faithful representation and relevance of financial information of listed companies (Maccarthy, 2022). Thus, studies were examined both globally and locally. According to Peace and Donald (2015), there is no evidence of extreme aggressiveness in income smoothness among Philadelphia manufacturing companies. According to Beneish (2001), earnings quality has deteriorated over time. Rao and Dandale (2008), Pajunen and Saastamoinen (2013) conclude that earnings smoothing is vital to the firm's survival. According to Feng-Li et al. (2011), income smoothness increased the number of stressed/bankrupt firms while decreasing the number of non-stressed/non-bankrupt firms. Thus, the findings from developed countries are inconsistent and cannot be generalized to the Nigerian economy.

Web metric analysis shows a draught in empirical literature on income smoothness and financial reporting quality in Nigeria. Abbot 2004; Bouaziz 2012; Zaman 2011; Muhammed 2014; Dichev et al. (2002), etc. Other research has found a strong correlation between corporate governance and financial reporting quality.

Given the above issues and the importance of addressing them, this researcher seeks to fill the content gap in the study titled earnings smoothness and quality of financial reporting, by introducing firm size as control variable and focusing on listed insurance companies in Nigeria.

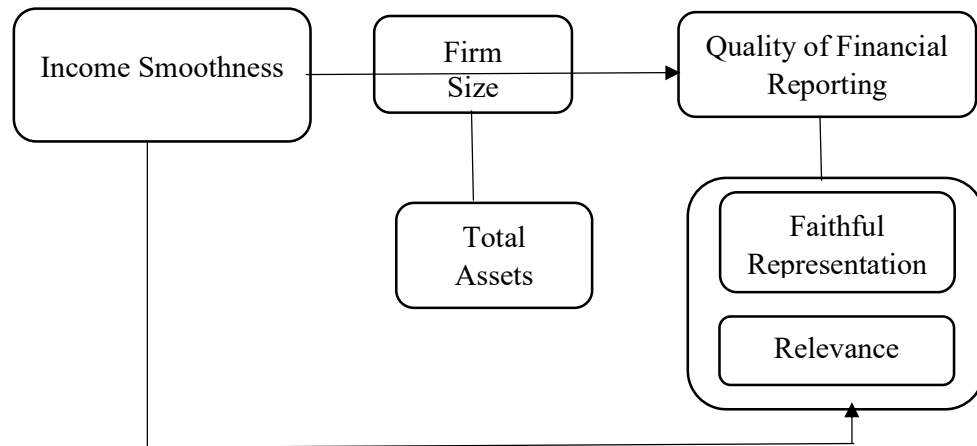


Figure 1.1 Conceptual Framework

**Sources of conceptualization:** Researchers Construct (2022).

### Aim and Objectives of the Study

The main aim of this study was to investigate earnings smoothness and financial reporting quality of listed insurance companies in Nigeria. With some specific objectives such as to:

1. examine the relationship between income smoothness and faithful representation of listed insurance companies in Nigeria.
2. evaluate the relationship between income smoothness and relevance of listed insurance companies in Nigeria.
3. Investigate the effect of firm size on the relationship between income smoothness and quality of financial reporting in listed insurance companies in Nigeria.

### Research Hypotheses

The following null hypotheses were tested at a 0.05 level of significance.

- Ho<sub>1</sub>: There is no significant relationship between income smoothness and faithful representation of listed insurance companies in Nigeria.
- Ho<sub>2</sub>: There is no significant relationship between income smoothness and relevance of listed insurance companies in Nigeria.
- Ho<sub>3</sub>: Firm size does not have any significant effect on the relationship between Income smoothness and quality of financial reporting in listed insurance companies in Nigeria.

### Income Smoothing

The term income smoothing refers to the changing of expenses and revenue for the purpose of presenting a deceitful imprint that a firm has stable earnings. Guillaume and Pierre (2016), advocate that income smoothing is one of the incentive accounting involves adjusting and manipulating fluctuations in some heights of earnings for the business. When it comes to earning management, there are two sentiments that are entail. The first prevails and regards the earning management as false, while in the second scenario, the stakeholders determine such doings as management using their preferences (Chhabra, 2016).

Zachary and Hambrecht (2015), examine the link between management fraud and income smoothing to see whether the two are associated with equity or not. According to them, the company may employ the "big bath" process to increase the accrued setbacks, in which the main

idea is to show a bigger loss in the current period followed by a bigger margin of profit in the next period. This is mainly done by factoring in future expenses into the current period instead of the correct next period. The result of this process, income smoothing, is that it reduces earnings quality because net income does not truly show the economic operation of the business for a given period of time. The main purpose is to balance income variability over some years by changing the income of a bad year with that of a good year. In the same way, income variability may be changed by shifting losses or expenses from time to time. For example, a business can reduce discretionary costs in the current financial year to advance current earnings, which will result in the coming year that discretionary costs will be expanded. Businesses make use of the following accounts: bad debts written off, warranty costs, sales returns, allowances, and pension expenses. This is in order to encounter quarterly earnings and occasionally increased losses in the coming year. Glaum (2018), says that the Union Carbide Corporation applied false accounting procedures for investment, tax and credits which increased their profits without necessarily adding the cash, termed as "*magic accounting*". According to Gaganis and Pasiouras (2016), in their research on smoothing income, they claim that those firms showing a steady growth rate usually mislead the markets. He came up with an idea supported by unusual observations and approximating risk methods. This holds that there exists a relationship between risk and income variance to affect the interpretation of the stakeholders of the firm's risk. According to international accounting standards, the process of income smoothing is not legal as it uses false accounting procedures and interpretations to stabilize fluctuations in net income (Acharya & Lambrecht, 2015). When businesses do income smoothing, there is no correct information to determine their actual earnings to avoid taxes. Income smoothing has been a topic discussed for many years, raising the question of whether it's ethical or not. As (Guillaume & Pierre, 2016) says, most people hold that manipulating income reduces the important aspects of financial reports and, more so, the accounting principles. (Acharya & Lambrecht, 2015) calls for the modification to improve the financial statements transparency in order for the interested parties to look at the actual numbers for their decision making.

An article written by Geoffrey and Muja (2014), showed that to get around management and auditor detachment accounting procedures, companies began "*channel stuffing*". In this, the company vessels products in excess of a client's requirements towards the closing stage of an accounting period to inflate revenues. Chhabra (2016), says that smoothing income can be applied with no inquiries from the stakeholders, hence the management does not disclose any information. The application of both the smooth income and the "*big bath*" is commonly referred to as creative accounting or earnings management. The practice of income smoothing, which stretches over a length of time, is common, whereas the phenomenon of "*big baths*" is based on the nonrecurring characteristics of transactions. This shows that income smoothing and "*big bath*" are two different methods as far as the extent of application is factored out. For example, company Z speculates that it may fail the stock markets. It forecasts for the current period and the management increases their loss to R50000 from R20000. They will do this by, for example, writing off an R15000 as an outmoded asset and increasing their depreciation by an additional R15000. This enables the company to indicate a profit of R30000 in the coming financial year, which in turn shows investors and clients that the company is doing well.

One of the methods that can be used to identify earning management is to contrast the reported profit of a company with its cash flow. If the profit earned is fine but there is a net cash flow, then the company is employing creative accounting (Collins, 2016). If the company has an ever-cumulating profit, cash flow at all-time cannot be noted. Hence, the company results in book entries to manipulate and increase profits. (Gaganis & Pasiouras, 2016), points out that the firm's smooth profits, so as to decrease its volatility, can serve as a reminder to the bad debt holders of the company that earnings have reduced volatility, hence portraying a decreased risk, and also makes the company's owners feel confident that there are stable earnings, hence improving relationships among the investors, management, and employees. According to (Capkun, 2016),

the application of smoothing may enable the company to benefit from government subsidies and tax holidays. All these reasons for smoothing are concerned with reducing the volatility of earnings, increasing the stock price and value of the company's stock, and the aspects related to financing. The book of entries is the main tool for smoothing income. It can be used differently to achieve a smoothing effect. Acharya and Lambrecht (2015), advocate that depreciation, over and under the provision in book entry, allowance book entry to include uncollected allowances, loans, and warranty obligations, are the main areas for smoothing income. Bora and Saha (2016) did research on income smoothing and advocated a framework to determine the income smoothing manner. He criticized other research for making use of one variable to determine income smoothing. He says "businesses use the joint effects of accounting variables in order to reduce income variables to a minimal". He used income and sales variables and concluded that income smoothing emerges from the alternating difference between sales and expenses. Gaganis and Pasiouras (2016), proposed that leeway from accounting procedures results in income smoothing done to minimize income fluctuations instead of reducing or increasing reported income. They did a test on firms with a smooth income and also the results of aimed factors toward income smoothing. The two did research to determine the relationship between income smoothing, the stock price and the return on investment. They used 500 companies as samples and determined information on net income, assets, and stock price equity for a period of eight years between 2001 and 2008. The result of their research showed that there existed a negative significant between income smoothing and return on investment.

### **Quality of Financial Reporting**

The primary objective of financial reporting is to provide high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision making (FASB, 1999; IASB, 2008). Martinez-Ferrero (2015), posits that financial reporting quality is the faithfulness of the information conveyed by the financial reporting process. The word faithfulness is characterized by relevance, reliability, transparency, and clarity (Jonas & Blanchet, 2000). Relevant information means that the financial statement should contain enough information useful to different users of the financial statements in assisting their decision-making process and that the information is provided in a timely fashion when it is still "news". Reliability is what assures that the information is reasonably free from error or bias and that it truly represents what it is intended to represent. Information in a financial report will be reliable to the extent that users can depend on it to judge the economic conditions or events that it purports to represent (Shehu, 2013). Transparency means that the figures truly reflect the economic activities of the enterprise during the period. Clarity is focused on how the figures are presented. The format and language of presentation are also very important. Financial reporting should therefore provide information to help investors, creditors, and other users to project the amounts and timing of future cash flows for the enterprise (Waweru & Riro, 2013).

### **Faithful representation**

Faithful representation is the second fundamental qualitative characteristic espoused in the IASB (2008) framework. According to IASB (2018), to faithfully represent economic phenomena which the information purports to represent, annual reports must be complete, neutral, and free from material error. IASB (2018), states that economic phenomena represented in the annual report are "economic resources and obligations and the transactions and other events and circumstances that change them. Faithful representation is usually measured in terms of neutrality, completeness, freedom from material error, and verifiability (Ibrahim et al,2019). Botosan (2004), argues that it is difficult to measure faithful representation directly by only assessing the annual report, since information about the actual economic phenomenon is necessary to assure faithful representation. However, Alice et al (2020), maintain that estimates and assumptions that closely correspond to the underlying economic constructs and the standards pursued can enhance faithful

representation. The proxies commonly used to measure faithful representation include: 1) freedom from bias; 2) neutrality; 3) unqualified audit report; and 4) corporate governance statement (Krishnan (2008). To be free from bias, financial reports should clearly explain assumptions and estimates made in the preparation of the financial statements, as well as the choice of accounting principles. A financial report is assumed to be neutral if it highlights both the positive and negative events in a balanced way (IASB, 2018).

### **Relevance**

IASB (2018), defines relevance as the capability of making a difference in the decisions made by users in their capacity as capital providers. Relevance is usually operationalized in terms of predictive and confirmatory value (Holland & Ramsay, 2013). Predictive value generally refers to information on the firm's ability to generate future cash flows. According to IASB (2018) information about an economic phenomenon has predictive value if it has value as an input to predictive processes used by capital providers to form their own expectations about the future. Predictive value is considered as an important indicator of relevance in terms of decision usefulness. The basic measures of predictive value, according to Hussaini et al., (2009) are: 1) the extent to which annual reports provide forward-looking statements; 2) whether the annual reports disclose information in terms of business opportunities and risks; and 3) whether the company uses fair value. The forward-looking statement usually describes management's expectations for future years of the company. For capital providers and other users of the annual reports this information is relevant since management has access to private information to produce a forecast that is not available to other stakeholders (Ibrahim et al, 2019).

A relevant financial report should include both financial and non-financial information. Such information should be able to provide insight into business opportunities, risk as well as possible future scenario for the company (Idris, 2012). Prior studies record that in comparison to historical cost, fair value presents a better predictive value of financial reporting information than historical cost (Idris., 2022; Jensen, H., & Meckling, 1976; Schipper & Vincent, 2013; Schipper, 2019; Subramanyam, 2014). Rahman (2016), argue that fair value accounting provides more relevant information than historical cost because it represents the current value of assets, instead of the purchase price. In addition, fair value is the accounting measure espoused by both the IASB and the FASB; and both frameworks consider fair value as one of the most important methods to increase relevance (Barth et al., 2001). In addition to predictive value, confirmatory value contributes to the relevance of financial information. According to IASB (2018) information has confirmatory value if it confirms or changes past (or present) expectations based on previous evaluations. Shiner (2016), argue that if the information in the annual report provides feedback to the users of the annual report about previous transactions or events, this will help them to confirm or change their expectations. Information relating to the confirmatory value are usually contained in the 'management, discussion and analysis' section of the annual reports (Sucuahi, & Cambarihan, 2013).

### **Firm Size**

Firm size refers to the speed and extent of growth that is ideal for a specific company. Most companies are intent on expanding the size of their business operations to allow them to grow either in revenue, profit, number of employees, or size of facilities (Pervan & Visic, 2012). Many companies compete in rapidly changing industries, which may be imperative for survival (Dogan, 2013). Another strategy for retaining growth involves employing employees who like to work for a company. These people tend to enjoy the diversity of the challenges they encounter in the company, and they often have a strong interest in the firm's products and can provide their expertise to customers.

Schiner (2016), noted that one of the factors influencing firm size is the availability of workers and other resources in the surrounding community where the business is operating. He further

suggested that it is possible for companies to outgrow the communities in which they operate, particularly when they are located in a remote area. Some factors that may indicate that a company has outgrown its operating community in size include; growing at a faster rate than the community labour force, providing more than one-third of the local government's funding through taxes, and being responsible for the death of the community if the company shuts down (Shiner, 2016). Firm size is measured as the natural logarithm of a firm's total assets, which can be easily regressed in order to determine the influence of the firm's total assets on its performance (Driffield et al. 2005). A lot of empirical studies have been conducted using firm size. Some of the mused firm size as a control variable while others used it as a predictor variable in their studies. Firm size is used in this study as an independent variable, because the study is on firm characteristics and size is among the proxies of firm attributes.

In this work, we used firm size as a moderating variable for the relationship between the audit committee and earnings quality. Research has shown that a relationship exists between firm size and earnings quality. Hashmi et al. (2016), used firm size as a control variable to study the relationship between corporate governance and earnings quality.

### **Firm Size and Income smoothness and quality financial Reporting**

Firm size is an attribute that affects financial reporting quality (Dechow & Ge, 2006). The firm size, in most cases, is measured by its asset size (Saheed, 2013). A large firm is expected to have a well-structured accounting and internal control department and should be able to afford the services of professionals who are expected to enhance the financial reporting process (Chalaki et al. 2012). They are also likely to have a well-built information system enabling them to track all financial and non-financial information for operational, tactical and strategic purposes (Saheed, 2013). This is because a well-structured accounting and internal control department will ensure the integrity of financial reporting. Internal control procedures are meant to detect and/or prevent both the ability to manipulate earnings as well as mistakes or errors (Dechow and Ge, 2006). In addition, large firms are able to engage the services of one of the big auditing firms to audit their financial statements, which is expected to enhance the quality of financial reporting (Thoopsamut & Jaikengkit, 2019) because the big audit firms are expected to be very professional in their auditing and be concerned about their reputations.

Waweru and Riro (2013) investigated the influence of corporate governance and firm-specific characteristics on earnings management. They found that company size is not significantly related to financial reporting quality; this is consistent with the results obtained by Missonier-Piera (2014), who investigated the economic choices of accounting methods in Switzerland, and the results obtained by Thoopsamut and Jaikengkit (2009), who asserted that company size is not a significant variable in determining financial reporting quality.

This line of argument, however, contradicts the findings of Thomas (2016), as cited by Waweru and Riro (2013), who assert that company size is a major factor shaping managers' choices in accounting in Japan. Shehu and Ahmad (2013) also documented that firm size has a significant effect on earnings quality. Their study argued that large manufacturing firms in Nigeria tend to report more reliable and qualitative information in their financial reports than small ones. According to the study, this may be attributed to a strong internal control system, governance mechanisms, and the ability to access high-quality service from large audit firms. The combination of these factors should discourage earnings management, which is expected to improve the quality of financial reporting. Moreover, Huang et al. (2012), while studying CEO age and financial reporting quality, using the meeting and beating of analyst earnings forecasts and financial restatements as a proxy for financial reporting quality, found that firm size is significant and negatively related to financial reporting quality.

Firm size will also affect corporate governance characteristics as well as the level of income smoothness (Becker, 1998). Besides, Shehu and Ahmad (2013), posit that large firms have very strong reasons for manipulating their earnings in order to keep a consistent earnings growth trend

and meet and beat earnings expectations. Contrary to Shehu and Ahmed's findings, Missonier-Piera (2014) and Thoopsamut and Jaikengkit (2019), posit that company size is not significantly related to financial reporting quality. Their work was not conducted in an emerging economy. It therefore could be that this divergent result is due to the level of economic development of the countries where the studies were conducted. If firm size is likely to affect the corporate governance characteristics as posited by Beckeret (2018), it is likely it will also affect the level of financial reporting quality.

### **Income Smoothness and Faithful Representation**

Guillaume and Pierre (2016), advocate that income smoothing is one of the incentive accounting involves adjusting and manipulating fluctuations in some heights of earnings for the business. When it comes to earning management, there are two sentiments that are entail. The first prevails and regards the earning management as false, while in the second scenario, the stakeholders determine such doings as management using their preferences.

When businesses do income smoothing, there is no correct information to determine their actual earnings to avoid taxes. Thus, there is no faithful representation. Income smoothing has been a topic discussed for many years, raising the question of whether it's ethical or not. As (Guillaume & Pierre, 2016) says, most people hold that manipulating income reduces the important aspects of financial reports and, more so, the accounting principles. (Acharya & Lambrecht, 2015) calls for the modification to improve the financial statements transparency in order for the interested parties to look at the actual numbers for their decision making.

### **Income Smoothness and Relevance**

Despite the impressive performance of the NSE, available records have shown that information contained in financial statements prepared by DMBs in Nigeria is not allied with their stock market value due to falsification of accounting numbers (SEC, 2013). The falsification of accounting information creates abnormalities in banks' financial statements, particularly and in capital market performance in general. The increasing rate of manipulative accounting information is therefore of great concern to investors, regulators, and other stakeholders because distorted accounting information can cause wrong decisions. The overall effect is wrong share pricing, which can cause a collapse of the capital markets, thereby contradicting the basic quality of financial reporting, which is assumed to result in a more efficient functioning of financial markets and reduce the cost of capital for the reporting entity. This is evident in the near collapse and present lull in the Nigerian capital market. The critical nature of the above problems underscores the imperative of this study, which seeks to evaluate the extent to which financial performance of quoted banks in Nigeria could be affected by faithful representation of accounting information (measured by absolute discretionary accruals), towards restoring investors' confidence in banks' financial statements and increasing investment in banks' stocks in the Nigerian capital market. The above core issues constitute the problems of this study.

## **Theoretical Framework**

### **Agency theory**

This study adopted agency theory to explain the relationship between income smoothness and the quality of financial reporting of listed insurance companies in Nigeria. Agency theory originated from the work of (Berle & Means, 1932). They explored the concept of agency and its applications to the development of large corporations. They found out how the interests of the directors and managers differed from the owners of the firm, thereby using the concepts of agency and principal to explain the genesis of those conflicts.

Jensen and Meckling (1976), further on the work of Berle and Means (1932), to develop agency theory as a formal concept. They also formed a school of thought arguing that corporations are structured to minimize the cost of getting agents (agency costs) to follow the direction and

interests of the principals. The theory essentially acknowledges that different parties involved in a given situation with the same given goal will have different motivations, and these differences can manifest in divergent ways. This means that there will always be partial goal conflict among parties, because efficiency is inseparable from effectiveness, and thus information will always be somewhat asymmetric between principal and agent. Agency theory is therefore concerned with the contractual relationship between two or more people, called agents, performing some services on behalf of the principal. Both the agents and the principal are presumed to have entered into a mutual agreement or contract motivated solely by self-interest. The principal delegates decision making responsibility to agents (Chowdhury, 2004).

### **Empirical Reviews**

Ben (2013), conducted to investigate the quality of financial reports before and after adopting IFRSs in Ghana, and also the influence of firm-specific characteristics, which include firm size, profitability, debt equity ratio, liquidity, and audit firm size, on the quality of financial information disclosed by firms listed on the Ghana Stock Exchange. The research was conducted through detailed analysis of the pre-official adoption period, (2006) and post-adoption period, (2008) financial statements of the listed firms. Descriptive analysis was performed to provide the background statistics of the variables examined. This was followed by regression analysis, which forms the main data analysis. The results of the quality of financial information disclosure of 76.80% (pre adoption) and 87.09% (post adoption) for the last two years indicate that the quality of financial reports has improved significantly after adopting IFRSs. The study thus confirms that the implementation of IFRS generally reinforces accounting disclosure quality. It also indicates listed firms' overwhelming compliance with the IASB's IFRS Framework. The results of the multiple regression analysis show that company size, represented by net assets, and auditor type were found to be associated at a statistically significant level with the quality of financial information disclosed. With the improvement in the quality of financial reports after adopting IFRS, users are assured of useful information for financial decision-making.

Shehu and Abubakar (2012), identified that corporate governance affects both financial performance and the opportunistic behavior of managers. Studies on the influence of corporate governance mechanisms on firm performance often overlook the possibility that reported earnings can be misrepresented by managers in order to achieve a variety of objectives. This paper examines the relationship between corporate governance and corporate financial performance when performance is stripped of the discretionary component of accruals. Secondary data was extracted from annual reports of the sample firms for the period between 2008 and 2010 and univariate OLS multiple regression was used as a tool for data analysis. The study documents that corporate governance significantly impacts on both adjusted and unadjusted firm performance in different magnitudes and directions. Specifically, it is empirically established that board composition is inversely related to true performance, while a positive interaction emerges between executive compensation and firm performance regardless of the performance specification.

Benjamin (2020), influenced the income smoothness practices of financial institutions listed on the Ghana Stock Exchange from the period 2010-2018. The study adopted a quantitative design, as data on Total Accrual, firm size, firm age, leverage, auditor size, and firm age were sourced from the published annual report of nine (9) financial institutions listed on the Ghana Stock Exchange from 2008 – 2018. The results from the regression model under a 5% significance level reveal that board size and financial leverage are the factors influencing income smoothness practice amongst listed financial institutions. The results from the correlation model also document a negative correlation between auditor side, financial leverage, and earnings management, while board size, firm size, and firm age reveal a positive correlation with earnings management. The study therefore recommends that the regulatory bodies of financial institutions ensure that listed firms are once in a while audited by the big four (4) audit firms. An independent committee should be set up to perform oversight responsibility for the board of directors.

Alice et al. (2020), investigated the combined effect of corporate governance components on the financial reporting quality of quoted financial and non-financial firms in Nigeria. The study adopted an ex-post facto research design. A purposive sampling technique was used to select 30 quoted financial and 30 quoted non-financial firms in Nigeria out of 161 listed companies on the Nigerian Stock Exchange for the period 2003-2017. Multiple regressions were employed to test the inferential statistics. Findings revealed that corporate governance (CG) has a joint significant effect on financial reporting quality (FRQ) of quoted financial and non-financial firms in Nigeria (Adj. R<sup>2</sup> = 0.41, F (6, 444) = 13.20, p 0.05), and (Adj. R<sup>2</sup> = 0.49, F (6, 444) = 15.51, p 0.05) respectively. The study concluded that corporate governance has a significant effect on the financial reporting quality of quoted financial and non-financial firms in Nigeria. The study recommended that management should ensure they comply with the code of corporate governance to give credibility to the financial report.

Lucky et al. (2020), examines firms' profitability and the quality of financial reports pre and post IFRS adoption in Nigeria. The main objective is to examine the effect of profitability on the earnings quality of firms, in addition to the impact IFRS has on the profitability of firms in Nigeria. The study uses the quantitative method of analysis, multiple regression analysis to examine what effect ROE and ROA have on earnings quality, and t-test of mean difference to test for the difference between the mean of pre and post IFRS adoption. To analyse earnings quality, discretionary accrual is measured using the Jones' model. The results show that the effect of profitability on the quality of earnings after the adoption of IFRS is mixed depending on what measure of profitability was adopted. ROE has a negative (positive) effect while ROA has a positive (negative) effect on discretionary accruals (earnings quality). On the impact of IFRS adoption on the profitability of firms, the results show a non-significant impact on the return on equity of firms and a statistically significant impact on the return on assets of firms. Overall, IFRS adoption has had a negative impact on the profitability of firms quoted on the floor of the Nigerian stock exchange.

Kenny and Luqman (2019), examined the impact of firms' characteristics on the quality of financial reporting of listed manufacturing firms in Nigeria. Some 25 nonfinancial firms listed on the Nigeria stock exchange from 2009 to 2016 comprised the sample. The study used longitudinal balanced panel data from secondary sources only because it is a quantitative with positivism paradigm and the core of the data needed for analysis was adequately and conveniently extracted from the audited financial reports of the selected firms within the study period. Multiple regression is adopted to examine the model of the study. Longitudinal panel data is used to account for individual heterogeneity of the sample companies with the utilization of two-step regression in determining the quality of financial reports of the Nigerian listed manufacturing firms adopting a modified Dechow and Dichev (2002) model. The firm characteristics are firm size, firm tangibility, profitability, and growth. The result revealed that firm size has a positive significant effect on financial reporting quality. Tangibility has a negative significant effect on audit financial reporting quality. Firms' profitability has also been argued to have a positive influence on the quality of financial reporting, while firm growth has a negative significant effect on financial reporting quality. Hence, large firms tend to produce high-quality financial reports; this should be encouraged among firms. This study also revealed that highly profitable companies have high financial reporting. Thus, profitability should be a good indicator of poor or good financial reports. On the other hand, tangibility and firm growth have a negative effect on financial reporting quality; this follows the predictions of the accruals model, which predicts that earning manipulation can be influenced by plant, property, and equipment (PPE). Hence, tangibility of assets should be discouraged among non-financial firms. It is therefore recommended that all the firm characteristics used in this study except tangibility and firm growth should be encouraged by the regulating agencies of the government (Securities and Exchange Commission and Corporate Affairs Commission) and all other stakeholders in Nigerian non-financial firms because of the role firm characteristics play in constraining managers to act opportunistically in preparing financial statements.

Erick (2011), established that the adoption of International Financial Reporting Standards (IFRS) in Kenya has been associated with higher accounting quality for listed companies. The International Accounting Standards Board (IASB), in its objectives and preamble, supposes that the beneficial effects of IFRS adoption include transparency, accounting quality, and reduced cost of capital. Based on these assumptions, this study applied accounting quality measures; earnings management, timely loss recognition and value relevance to find out whether the adoption of IFRS has led to improvements in accounting quality in companies listed in Kenya. The methodology is based on prior literature definitions of metrics of accounting quality, mainly earnings management, timely loss recognition, and value relevance. The study differs from the previous ones by overcoming difficulties in controlling for confounding factors faced in previous studies, which could have led to less reliable results. Three out of the eight metrics indicated that quality had marginally improved, while five indicated that it had marginally declined. These mixed outcomes are very much in line with findings in other studies and the study contributes to the debate by explaining why accounting quality outcomes are still not consistent with IFRS promises in spite of improved test conditions.

Uwalomwa and Omoike, (2017), examined the relationship between disclosure quality and income smoothness in Nigerian banks. The study employed a cross-sectional research design comprising 11 banks for a period of 6 years (i.e. 2009-2014). The annual report was used to collect the data. The modified Jones model was used to measure discretionary accruals, which is a proxy for earnings management, while a disclosure index was used to capture the quality of disclosure. The Ordinary Least Square Regression technique was used to analyse the data. Findings from this study provide support for the legitimacy theory as disclosure quality was found to be negatively related to earnings management.

Otuya et al. (2017), examined the relationship between income smoothness and the quality of corporate governance in Nigeria. The study adopted the content analysis research design and data was obtained from the financial statements of sampled companies. The population of the study consists of all companies listed on the Nigeria Stock Exchange. The study, using data from annual reports of manufacturing companies for the period 2012 to 2016, analyzed some simple descriptive and correlation statistics and used regression to examine the relationship between the variables highlighted in the study. The study showed that the quality of corporate governance, audit committee strength, and executive compensation have a significant negative relationship with earnings management. The study therefore concludes that good corporate governance practice has a significant effect on reducing earnings manipulations, which, by extension, improves the quality of financial reporting, and recommends, amongst others, that audit committees should be strengthened by emphasizing independence and active participation of members in meetings.

Elekwachi et al. (2017), focused on ascertaining the relationship between earnings management and financial reporting quality of beverage firms in Nigeria. To achieve this objective, various earnings management and financial reporting concepts, principles, theories, and assumptions were relied upon. In addition to reviewing theoretical and empirical literature on the above perspective, information was collected from journals, textbooks, and articles relevant to the subject matter, and financial reports obtained online from some beverage firms. Agency theory and supporting theories of stakeholders' theory and resource dependency theory were adopted for this paper. The paper concludes that earnings management may be the result of opportunistic behaviour of management and, therefore, has the potential to compromise the quality of the financial report. The paper findings indicate that firms in the beverage sector with more outsider boards of directors have a propensity for greater monitoring and, therefore, are expected to insist on greater accounting disclosure, which gives rise to high financial reporting quality. Earnings management, financial reporting quality, opportunistic behaviour, outsider board of directors, accounting disclosure, accounting policies, stakeholders.

Folajimi et al. (2019), investigated the effect of corporate governance on the earnings quality of quoted financial and non-financial firms in Nigeria. Earnings have been the backbone of the

organization and the gateway to its existence over the years. The paper adopted an ex-post facto research design from the population of 161 listed companies on the Nigerian Stock Exchange as at 31st December, 2017. 30 quoted financial and non-financial firms were purposively selected from 2003-2017. Using multiple regression analysis, the findings revealed that corporate governance (CG) had joint significant effects on earnings quality (EQ) of quoted financial firms in Nigeria (Adj. R<sup>2</sup> = 0.42, F (6, 444) = 13.09, p 0.05). Board size had a significant positive effect on earnings quality, while board meetings had a significant negative effect on earnings quality. CG had joint significant effects on EQ of quoted non-financial firms in Nigeria (Adj. R<sup>2</sup> = 0.53, F (6, 444) = 13.42, p 0.05). Board meetings had a significant negative effect on EQ. It recommended that board size should be maintained by the organization while board meetings should be critically looked into by the management to ensure maximum utilization of resources. Corporate governance, Earnings quality, Financial firms, Non-financial firms, Nigeria.

Matthew and Stephen (2016), investigated the effects of corporate governance variables on earnings management among selected listed firms from the manufacturing and banking sectors. A sample of 24 listed companies from the 2 sectors' population of 63 was examined to gather empirical data from 2008 to 2013 using multiple regression tools. Employing the panel data analysis approach, board independence, audit committee independence, and audit committee size are insignificantly positively correlated with earnings management. Board size is insignificantly negatively correlated with earnings management, while the ownership structure is insignificantly negatively correlated with earnings management. Audit quality is positively correlated with earnings management, though not statistically significant. Based on these findings, the study concludes that corporate governance structures, as they were, have not helped to address earnings management. The study recommends, among other things, considering the first 4 hypotheses, that investors should invest in companies with moderate-to-high debt-to-equity ratios as lenders are able to externally monitor companies. It also recommended that regulatory bodies should frequently discharge their supervisory roles by monitoring companies' activities to ensure compliance.

Isah (2017), examined the impact of firm attributes on the earnings quality of DMBs in Nigeria. The study used data extracted from the financial statements of 14 listed DMBs in Nigeria for the period of 2009 to 2015. The study also employed panel data multiple regression technique. The change et al. 2008 model of discretionary loan loss provision was used as a proxy of earnings quality, while firm attributes were proxied by firm size, profitability, liquidity, leverage, and ICT intensity. The results revealed that liquidity, profitability, and ICT intensity have a significant positive impact on earnings quality, while firm size has a significant negative impact on earnings quality. However, leverage was found to have an insignificant impact on the earnings quality of DMBs in Nigeria. Hence, it is recommended that large banks should create window services to enable them to respond quickly to profit-making opportunities. The CBN should encourage banks to invest more in less risky business ventures with fixed interest charges. The NDIC should encourage banks to create a liquidity cushion in addition to the CBN minimum liquidity requirement and shareholders should insist on a considerable amount of their annual investment in ICT.

discrete, and observed events which can be represented by universal prepositions, constant conjunctions, or regular patterns of events. In its epistemology, knowledge is derived from sensory experience, concepts and generalizations which are summaries of particular observations. Empiricism philosophy study of social research makes a distinction between the language of observation and the language of theory. All forms of empiricism draw a clear distinction between facts and propositions that have been verified by experience and experiment, and values which are subjective beliefs or opinions (Heywood, 2000).

Thus, this study provides valued and acceptable reality and knowledge of the content variables and sub-variables of earnings management on the financial reporting quality insurance firms in Nigeria in orderly atomistic, discrete and observed events in Nigeria which are represented by universal prepositions and regular patterns of events. And clear distinctions were made in the

study based on observation and theories verified through experience and experimentation of factual secondary data; on the basis of rigorous compilation of seven years of secondary data from relevant insurance companies in Nigeria, by introducing and studying 'earnings management' sub-variables (accrual earnings, income smoothness, and earnings persistence) and measures of 'quality of financial reporting' (faithful representation and relevance) which previous studies did not consider or rarely studied.

### **METHODOLOGY**

The expo facto designs. The population of the study was the twenty-five (25) listed insurance companies in the Nigerian Stock Exchange during the period 2013 -2019 (7) years. The sample size of this study is twenty-one (21). This number is derived by the application or use of Taro Yamane formula for sample size determination. Out of the twenty-four (24) companies, three (3) companies have incomplete financial statements which leave the sample size to be twenty-one (21) listed insurance companies. The study employed the use of secondary data. The formulated research questions were analyzed with descriptive statistics. The hypotheses were tested using the simple regression analysis with the aid of E-view (10).

### **Operational Measurement of Variables**

The aim of the study is to ascertain empirically the relationship in terms of effect that exist between income smoothness and quality of financial reporting in listed insurance companies in Nigeria.

**Table 3.2 Operational Measurement of Variables**

Variable	Type of Variables	Measurement Scale		Source of Data
Income smoothing	Dimension of independent variable	Eckel model of (1981) was adopted to measure income-smoothing practices		Annual report
Faithful Representation	Measure of Faithful Representation on variable is a construct, that comprises of dependent variable.	1. Completeness	Completeness / Verifiability of information (e.g. Jonas and Blanchet, 2000; Maines and Wahlen, 2004)	Annual report
		2. Neutrality / Free from bias	Predictive value of both gains and losses (e.g. Dechow et al., 1996; Sloan, 2001, McMullen, 1996; Razaee, 2003; Cohen et al., 2004;	
		3. Unqualified auditor's report	External auditor's report (eg Ferdy et.al., 2009).	
		4. Corporate governance statement	Board of Directors statements / codes (eg Ferdy et.al., 2009).	
Relevance	Measure of dependent variable	Shareholding Average proportion of total outstanding shares held by the majority shareholders. The weighted average number of shares is calculated by taking the number of outstanding shares and		Annual report

		multiplying the portion of the reporting period those shares covered, doing this for each portion and, finally, summing the total (Saverio Bozzolan, Barbara Sveva Magnanelli and Maria Trovato, 2017).	
Firm size	Moderating variable	The log of total assets	Annual report

**Sources:** Beest et al., (2009); Cheung et al. (2010); Willekens (2008), Feng-Li et al. (2011) and Dechow and Schrand (2003), Dechow and Dichev (2002) and Ferdy et.al., 2009) and Saverio et al. (2017).

**NOTE:** Since the four measures of faithful representation in above table can be found qualitatively in the financial reports of the insurance companies. To transform the qualitative information to quantitative data for analysis purpose, the researcher's assigned one (1) for each attributed measures found in the financial statement. On the other hand, zero (0) was assigned for any attribute measure that was not found in the financial statement.

**Model Specifications**

Baxter and Cotter (2009) and Emmanuel et al. (2014), regression analysis is concerned with the study of how one or more variables affect changes in another variable.

Thus, the formula for regression:  $\psi = a_0 + bx + e \dots\dots\dots 1$

- Where:
- $\psi$  = index of outcome variable
  - $a$  = constant term for the independent variables
  - $b$  = index of predictor variable
  - $x$  = coefficients
  - $e$  = error level

The Income Smoothness (INSM) defined as three components used in the study. Whereas quality of financial report (QFR) its measures are faithful representation (FREP), relevance (REV).

The following 6 models were used to analyze the bivariate relationship between the variables.

Where;

- INSM** = Income Smoothness
- FREP** = Faithful Representation
- REV** = Relevance
- $\beta_0$  = Constant term (y intercept)
- $\beta$  = Coefficient of the independent variable
- $\psi$  = Error term (causes of Faithful Representation or Relevance not explained by variables in the model)

**The First Model:** The first hypothesis test model; shows the relationship between faithful representation and income smoothness:

$$FREP_{it} = \beta_0 + \beta_1(INSM)_{it} + \psi (.05) \dots\dots\dots 3.1$$

**The Fifth Model:** The fifth hypothesis test model; shows the relationship between relevance and income smoothness:

$$REV_{it} = \beta_0 + \beta_1(INSM)_{it} + \psi (.05) \dots\dots\dots 3.2$$

**Data Analyses and Results Interpretations**

**Univariate Descriptive Analysis**

The following table present the summary of the descriptive statistics of the data collected for the measures of the explanatory variables dimension (Income Smoothness (INSM), also of dependent variable measures {Faithful representation (FREP) and Relevance (REV)} which containing mean, median, maximum, minimum, standard deviation, skewness and kurtosis, Jarque-Beta and its statistical probabilities are revealed.

**Univariate Descriptive Analysis**

	INSM	FREP	REV
Mean	0.081724	3.800000	84.58600
Median	0.118050	1.003000	46.12000
Maximum	0.375000	1.000000	67.4110.0
Minimum	0.00000	1.000000	0.000000
Std. Dev.	0.141070	2.172379	27.19018
Skewness	1.577858	2.285974	6.957267
Kurtosis	2.747249	7.530709	49.79698
Jarque-Bera	6.064771	181.2564	10428.13
Probability	0.048201	0.000000	0.000000
Sum	8.499300	714.0000	882796.6
Sum Sq. Dev.	2.049768	490.8000	7.71E+10
Observations	147	147	147

Source: Data Result from E-view (v.12), 2022

Table 4.1 shows that the descriptive statistics of the data collected for the independent variable's dimensions of the study. The mean value of income smoothness (INSM), 0.081724. Also the maximum and minimum values of income smoothness (INSM) were 0.375000 and 0.000000. On the other hand, the standard deviation values of 0.141070 signifying that the data deviate from the mean values, which implies that there is a wide dispersion of the data from the means because the standard deviation is closed to the mean.

**Simple Regression Analysis and Results Interpretations**

**The First Model:** The first hypothesis test model; shows the relationship between faithful representation and income smoothness:

$$FREP_{it} = \beta_0 + \beta_1(INSM)_t + \bar{U} (.05) \dots\dots\dots 3.3$$

Dependent Variable: FREP

Method: Least Squares

Date: 09/16/21 Time: 09:47

Sample: 1 147

Included observations: 147

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INSM	-1.922139	1.601099	-1.200512	0.2328
C	0.224965	0.038130	5.899974	0.0000
R-squared	0.492922	Mean dependent var		9.336943
Adjusted R-squared	0.374021	S.D. dependent var		3.219996
S.E. of regression	1.174059	Akaike info criterion		4.603405
Sum squared resid	1.999780	Schwarz criterion		5.514528
Log likelihood	-72.55959	Hannan-Quinn criter.		6.572725
F-statistic	0.931489	Durbin-Watson stat		1.526939
Prob(F-statistic)	0.000027			

Source: Researcher's Statistical Result from E-view (v.12), 2022

From the table output above, the coefficient of INSM and FREP is -1.922139. This value implies that for every unit increase in FREP is predicted to be accompanied by a 1.893836-unit decrease in INSM.

The T-statistics is above 2, which is sufficient statistical evidence of significant @ 1% T-stat confidence level. The Prob value of INSM is 0.2328, which means the relationship between INSM and FREP is statistically insignificant at the 5 percent significant level.

The result also showed that the R2, which measures the goodness of fit, is 0.492922, meaning that 49 percent of the variation in the faithful representation can be explained by the dimension of the independent variables. The result indicates that the model is proper and adequate for the study. The model's goodness of fit and appropriateness is also supported by the outcomes of F-statistics and probability of F-statistics of 0.931489 and 0.000027 respectively. The Durbin-Watson statistics of 1.526939 also indicate the absence of serial autocorrelation.

**The Second Model:** The second hypothesis test model; shows the relationship between relevance and income smoothness:  $REV_{it} = \beta_0 + \beta_1(INSM)_t + \psi (.05) \dots\dots\dots 3.6$

**MODEL**

Dependent Variable: REV  
 Method: Least Squares  
 Date: 08/10/21 Time: 09:52  
 Sample: 1 147  
 Included observations: 147

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INSM	-18784.79	20085.16	-0.935257	0.3519
C	17.27040	8.077037	2.138210	0.0400
R-squared	0.736044	Mean dependent var	67.85714	
Adjusted R-squared	0.738348	S.D. dependent var	72.08091	
S.E. of regression	36.87078	Akaike info criterion	41.10816	
Sum squared resid	44861.99	Schwarz criterion	11.19704	
Log likelihood	-77.48928	Hannan-Quinn criter.	14.13884	
F-statistic	0.994358	Durbin-Watson stat	2.283710	
Prob(F-statistic)	0.000091			

*Source: Researcher's Statistical Result from E-view (v.12), 2022*

From the table output above, the coefficient of INSM and REV is -18784.79 This value implies that for every unit increase in REV is predicted to be accompanied by a -18784.79-unit decrease in INSM.

The T-statistics is above 1, which is sufficient statistical evidence of significant @ 1% T-stat confidence level. The Prob value of INSM is 0.3519, which means the relationship between INSM and REV is statistically significant at the 5 percent significant level.

The result also showed that the R2, which measures the goodness of fit, is 0.736044, meaning that 74 percent of the variation in the relevance can be explained by the dimension of the independent variables. The result indicates that the model is proper and adequate for the study. The model's goodness of fit and appropriateness is also supported by the outcomes of F-statistics and probability of F-statistics of 0.994358 and 0.000091 respectively. The Durbin-Watson statistics of 2.283710 also indicate the absence of serial autocorrelation.

**Analysis on the Moderating Variable**

Ho<sub>3</sub>: Firm size does not have any significant moderating effect on the relationship between earnings smoothness and quality of financial reporting in listed insurance companies in Nigeria.

**Partial Correlations**

<b>Control Variables</b>	EM	QFR
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		Correlation	1.000	.618
	INSM	Significance (2-tailed)	.	.026
		df	0	76
FMSIZ		Correlation	.618	1.000
	QFR	Significance (2-tailed)	.026	.
		df	76	0

*Source: Researcher's Statistical Result from SPSS V.24*

From the output of the partial correlation explains that, firm size bears a significant influence on the relationship between income smoothness and quality of financial reporting in listed insurance companies in Nigeria. The correlation coefficient of 0.618 means that, firm size positively influences the interplay of income smoothness and the quality of financial reporting as depicted by the probability level of 0.026 which is lesser than the chosen alpha level of 0.05, thus leading to the rejection of the null hypothesis and accepting the alternative hypothesis. Hence, there is significant influence of firm size in the relationship between income smoothness and quality of financial reporting in listed insurance companies in Nigeria.

### Summary Results Findings

#### Summary Computation of Hypotheses Results

Hypotheses	Coefficient	Std. Error	T-Stat	P-Value 0.05	Statistical Decision	Result	Correlation Sta.
H0 <sub>1</sub>	-1.922139	1.601099	-1.200512	0.2328	Insignificant	Accepted H0 <sub>2</sub>	Significant
H0 <sub>2</sub>	-18784.79	20085.16	-0.935257	0.3519	Insignificant	Accepted H0 <sub>6</sub>	Significant
H0 <sub>3</sub>				0.026	Significant	Rejected H0 <sub>7</sub>	

*Source: Researcher's Computation, 2022*

### CONCLUSION

There is insignificant relationship between income smoothness and faithful representation of listed insurance companies in Nigeria. There is insignificant relationship between income smoothness and relevance of insurance companies in Nigeria. There is significant influence of firm size in the relationship between income smoothness and quality of financial reporting in listed insurance companies in Nigeria.

### RECOMMENDATIONS

The findings of the study have important policy implications, which led to the making of the following recommendations below:

1. Insurance companies should reduce the rate of income smoothness to enhance the credibility and financial reports quality.
2. Regulators should not mainly rely on accounting numbers to govern the listed insurance firms, but should make sure they strictly abide by the rules, regulations, and ethics of international standards governing the preparation and presentation of financial reporting in order to avoid continuous smoothing of income and presenting falsified financial statements.
3. The peer review mechanism of audit committees in the industry should be encouraged and implemented vigorously and be used as a platform to set benchmarks for effective monitoring.

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