



Executive Compensation, Corporate Governance and Financial Reporting Quality: Evidence from listed firms in Nigeria

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Abstract

In many emerging economies with less efficient market systems like Nigeria, investors tend to rely on financial reports for decision-making. Managerial opportunistic behavior is associated with the need to achieve performance-based remuneration targets. However, corporate governance mechanisms are established to monitor managerial affairs which are believed to curb such behaviors. Hence, this study assesses the influence of executive compensation on the quality of financial reports with an interactive effect of corporate governance in Nigerian listed firms. The population of the study comprised all listed companies on the Nigerian Exchange Group (NGX) from which 74 firms were selected. Executive compensation was proxied with the chief executive officer's total remuneration, and the corporate governance index was adopted as a measure of corporate governance. The discretionary accruals from the modified Jones model by Kothari, Leone, and Wasley (2005), and the accruals of Dechow and Dichev (2002) proxied for financial reporting quality. The estimation results showed that the interactive effect of executive compensation and corporate governance has a significant and negative influence on discretionary accruals, which indicates a positive relationship with reporting quality.

Keywords

Financial Reporting Quality, Agency Theory, Corporate Governance, Executive Compensation

Jel Codes: G34, M12, M41

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1. Introduction

Financial reports are a subject of interest to many people, particularly investors, academia, stakeholders, analysts, government, regulatory agencies, and firms' host communities, among others. Two schools of thought exist on the primary objective of financial reporting. One supports the 'stewardship' objective, while the other, the 'decision-usefulness' concept.

The stewardship objective of a financial statement is aimed to assess the capability of managers on the efficient use of resources entrusted to them to achieve the firm's objectives while decision- the usefulness objective reveals that financial reports are prepared to help users make a relevant decision on their investments (International Accounting Standards Board [IASB], 2018). It is believed that while financial information is prepared for making decisions, users are also able to make decisions on the integrity and effectiveness of managers in achieving the firm's objectives. Hence, it can be said that the 'decision-usefulness' objective results in the provision of information for stewardship purposes (Zeff, 2013).

Thus, the goal of reporting is to enhance decision making through the preparation and presentation of relevant information to investors and creditors on their investments (IASB, 2018; FASB, 2018).

Although quality information is used for economic decisions, the term 'quality' is complex and cannot be directly observed (Barth, Landsman & Lang, 2008). Most empirical studies have defined financial reporting quality based on measures of assessment or attributes of financial information. For instance, Palea (2013) opined that high-quality accounting information is value-relevant. The value-relevant construct refers to the relationship between accounting figures and stock price. It suggests that information is value-relevant when it explains stock returns. In other studies, measures such as income smoothing, timely-loss recognition, accruals, and benchmarking, among others are used as measures for financial reporting quality (Dechow & Dichev, 2002; Dechow, Ge & Schrand, 2010; Francis, Olsson & Schipper, 2006; McNichols 2002). Therefore, there has not been a comprehensive and acceptable definition of the concept.

Managers are significant participants in the reporting process and are solely responsible for the preparation of true and fair financial reports. The Sarbanes-Oxley Act (2002) states that the Chief Executive and Finance Officer of an entity certify the accuracy of the financial reports. Such requirements are intended to increase the managerial responsibilities for the financial report of the firm and seek to reduce managers' unethical/fraudulent behavior (Huang, Rose-Green & Lee, 2012). Notwithstanding, managers tend to be involved in deceptive practices as a result of information asymmetry. Information asymmetry occurs because of an agent-principal relationship. Therefore, Jensen and Mecking (1976), and Fama (1980) documented that the individualistic and

opportunistic behavior of managers (agents) increases the information advantage they have over shareholders (principals).

The agent-principal relationship is formed from the practice of separation of ownership and management of an entity. This leads to agency costs faced by principals where managers pursue goals at the detriment of the shareholders' interests. Policies employed to reduce agency costs include monitoring and bonding mechanisms. A major monitoring and bonding mechanism are the corporate governance and managerial incentive schemes, respectively. The principal uses the compensation package to induce agents to act in their interest. Remuneration is employed to align the interests of shareholders and managers such that the compensation plan is linked to the firms' performance (Scott, 2014).

Executive compensation scheme includes salary (including basic and other allowances), bonus schemes, stock grants, and other long-term incentives. Executive compensation has been a popular research topic with publications of highest paid executives in major magazines such as Forbes, Entrepreneur, Bloomberg etc. Compensation packages tend to be linked to performance targets; that is, the manager is paid based on his ability to meet specified performance targets (Hass, Tarsalewska & Zhan, 2016; Junaidu & Sani, 2014). However, in some cases, the performance target is not achievable, which may translate into forfeiting the bonus attached. Ordinarily, the introduction of performance targets as a basis for management remuneration should be a source of motivation, but due to the individualistic nature of humans it has led to an undesirable outcome.

Managers, in order to earn a satisfactory level of compensation, could engage in opportunistic behaviors such as the manipulation of financial information which shows a false performance of the entity. Executive compensation has been documented to influence accounting manipulations (Adeoye *et al.* 2021; Armstrong, *et al.*, 2013; Hass *et al.* 2016; Hassen, 2014; Zhou, *et al.* 2018). This behavior affects the quality of financial reports prepared by these managers and the decisions made by users.

As a result of incessant corporate scandals and fraud cases, regulatory bodies developed codes of corporate governance to regulate the activities and enhance best practices in organizations. While the corporate governance mechanisms are expected to improve firms' performance, it also serves as an important system in monitoring the affairs of managers, hence, an association between both structures could improve firms' performance and by extension reporting process.

The corporate governance system plays a paramount role in solving agency problem which exists between owners and managers (Conyon, 1997). The association between corporate governance and reporting quality can be linked to information asymmetry and agency costs incurred by owners (shareholders). Amongst the numerous functions

of corporate governance is to ensure compliance with the regulatory and reporting provision, review of internal controls, and oversight of the integrity of financial reports (Securities and Exchange Commission Code, 2011). This, in turn, enhances investors' confidence in the reports produced by management.

The motivation for this research arises from the irregularities in financial statements over time which have been linked to managerial practices and a weak governance structure. Moreover, there are several sectorial governance codes issued by regulatory bodies in Nigeria. These codes include the Financial Reporting Council of Nigeria (FRCN) Nigerian Code of Corporate Governance, 2018; the Code of Corporate Governance for Banks and Discount Houses in Nigeria 2014 issued by the Central Bank of Nigeria; the SEC Code of Corporate Governance for Public Companies in Nigeria 2011 (replacing 2003 Code); the National Pension Commission's Code of Corporate Governance for Licensed Pension Fund Operators 2008; the Code of Corporate Governance for Insurance Industry in Nigeria 2009 issued by the National Insurance Commission among others. While there are issues with the unification of the Codes, the FRCN Code is to be adopted by all publicly quoted firms, and there is no policy stating the previous codes are to be disregarded. Thus, companies are to align and incorporate the Code (FRCN Code) and their sector-based governance codes. However, where there are conflicting issues, the FRCN Code is to be maintained.

Furthermore, executive compensation is pronounced in Nigeria because of the annual publication of top-paid CEOs of publicly listed firms in Nigeria (Owoeye, 2019). This emanates from empirical findings showing a significant association between executive pay and the performance of firms. Thus, this study assesses the impact of executive compensation on financial reporting quality with a moderating effect on corporate governance in Nigeria. The remaining sections of this paper include the review of relevant literature; methodology; discussion of regression results; and conclusion.

2. Literature Review and Hypotheses Development

2.1. Executive Compensation

The remuneration of managers refers to the financial rewards and benefits of top management (Akewushola & Saka, 2018). Executive compensation usually comprises a mixture of salary, bonuses, share options, and other long-term incentives taking into consideration government and regulatory policies (Adegoye, Sunday, Soyinka & Ogunmola, 2017). Matters arising from the sensitivity of the directors' pay package to the firm's growth (Armstrong *et al.* 2013). This sensitivity is defined as a change in directors' pay for a one-percent change in equity change (Armstrong *et al.* 2013; Brick, Palia & Wang, 2013; Conyon 1997; Cooper, Gulen & Rau, 2009; Jensen & Murphy,

1990). The relationship between executive remuneration and firms' performance leads to the opportunistic behavior of managers (Adeoye, et al. 2021; Armstrong et al. 2013; Conyon & He, 2016; Johnson, Ryan & Tian, 2009; Oyerogba, Riro & Memba, 2016). Also, this affects the future operations of the firm, especially in a case, when current losses are shifted to future periods. However, studies have recommended that executive compensation policy should be reviewed to eliminate the association with performance targets (Hass *et al.* 2016; Oyerogba. et al. 2016; Sun, 2014).

In Nigeria, the relevant Company Act, Companies and Allied Matters Act (CAMA, 2004), and governance codes such as SEC Code (2011), and CBN Code (2014) set policies concerning directors' remuneration. While CAMA confers the power for setting directors' remuneration to shareholders (Section 267); SEC and CBN code states that a Remuneration Committee is set up for such purpose. Also, these regulatory bodies prohibit some specific compensation schemes except those approved by shareholders. For instance, CAMA prohibits companies from making payments for loss of office, or in connection with the directors' retirement, tax-free payments, or loans (Section 269-272, CAMA).

2.2. Corporate Governance

This is a structure of relationships that drives good corporate culture for managers and employees (Fagbemi, Abogun & Salam, 2013). Corporate governance is also concerned with the relationship among the shareholders, board of directors, management, and other stakeholders of the firm (Igbekoyi & Agbaje, 2018). In addition, the firm governance system refers to the set of processes, procedures, structures, and policies that define the way shareholders' resources are managed in an entity, to safeguard their (shareholders) interests (Abogun et al. 2016; Chi-Chi & Friday, 2016).

Corporate governance mechanisms are established to control and monitor the affairs of the firm. These mechanisms bridge the gap between the agents and principals. Also, corporate mechanisms are expected to curtail managerial opportunistic behavior. Therefore, Celik and Tian (2018) opine that better corporate governance should lead to higher economic growth through enhanced firm performance.

In recent studies, corporate governance indices are used to obtain more comprehensive information on a country's governance environment (Aguilera & Desender, 2012). La Porta *et al.* (1998); and Gompers, Ishii, and Metrick (2003) studies were the famous early studies that developed corporate governance indices. Since then, governance indices have been developed in various studies, though with varying components.

This study adopts the self-constructed corporate governance index in the study of Munisi and Randoy (2013). There are five sub-divisions of the index. These are

the Board of Directors, Remuneration committee, Audit committee, Disclosure and transparency, and Shareholders' rights. This is not an exclusive index that identified all the components of corporate governance, however, it identified important and sufficient governance mechanisms identified in the several corporate governance codes in Nigeria such as FRCN Code (2019), SEC Code (2011), and CBN Code (2014). The index identifies relevant components and requirements of these divisions.

2.3. Financial Reporting Quality

Reporting quality is the extent to which reported earnings faithfully represent underlying economic conditions and reflect the underlying accounting concepts (Mazzioni & Klann, 2018; Yoon 2007). Umobong (2016) opine that the quality of a financial report is to a degree at which financial information helps users to meet their decision needs regarding relevance, reliability, timeliness, comparability, and understandability. Furthermore, this is the ability through which financial reports communicate relevant information to stakeholders on a firm's activities especially its expected cash flows (Verdi, 2006).

This study considers reporting quality as the degree of usefulness of financial information in making an accurate and precise decision by users of financial statements. That is, the extent to which reliance can be placed by users on the accuracy of the information in the financial statement for relevant decision-making because the financial reporting system facilitates capital allocation decisions (Habib & Jiang, 2015).

A financial report is a communication tool revealing the performance of the company over a specific period. More so, credible financial reports mitigate agency costs (Jensen & Meckling, 1976). Therefore, high reporting quality is perceived to reduce information asymmetry. Ultimately, financial reporting serves several different expected outcomes, this includes economic growth. Although, the quality of financial reports does not drive economic growth directly; this growth is enhanced through several areas which include good business performance. Hence, the quality of financial reports may be defined as the measure to which the information on the financials is in line with the underlying economic events (Chen, Tang, Jiang & Lin, 2010). Thus, aligning the objective of financial reports by the IASB and FASB, financial reports provide information on decision-making investment (FASB, 2018; IASB, 2018).

Quality is subjective and might be difficult to define. As such, various studies employ earnings attributes as a reporting quality measure. In the extant literature, financial reporting quality is proxied with measures of earnings quality because earnings are much easier to detect and it serves as a paramount measure of the process of reporting

(Francis *et al.* 2006; Menicucci, 2020). By this, varying measures used to proxy for financial reporting quality include accruals, value relevance, persistence, smoothing, and predictability among other qualities (Choi & Pae, 2011; Dechow *et al.*, 2010; Ewart & Wagenhofer, 2011; Istianingsih, 2021). In other studies, financial reporting quality indices have been developed based on the characteristics of financial information pointing to the limitation of financial-based measures (Beest, Braam & Boelens, 2009; Braam & Beest, 2013; Mahboub, 2017).

The study hypothesizes that:

H1: Executive compensation is negatively and significantly associated with the financial reporting quality of listed firms on the Nigerian Exchange Group.

H2: Corporate governance is positively and significantly related to the quality of financial reports of listed firms in Nigeria.

H3: The interactive effect of executive compensation and corporate is positively significant to the financial reporting quality of quoted firms in Nigeria.

3. Study Methodology

3.1 Population and Sample selection

The study population consisted of quoted firms on the Nigerian Exchange Group (NGX) as of 31st December 2021. The research covered the period from 2012 to 2018.

However, the sample used in the study was based on the following filters:

Table 1
Sample Filter and Selection

Sample	Number of firms
Listed firms as at year end 2021	156
Companies with incomplete records	(26)
Firms without executive compensation disclosure	(48)
<i>Final sample for the study</i>	74

For a firm to be selected, it must be publicly listed as of 2012. The selected year 2012 was chosen as the base year due to the adoption of IFRSs in Nigeria which affects the quality of financial reports. The firm must have complete data on executive compensation from the period 2012 to 2018. Companies that did not disclose information on executive compensation were excluded from the study. As a result, seventy-four (74) companies were selected including financial institutions which met the above requirements.

3.2. Model Specification

The panel data model is specified as:

$$FRQ_{it} = \beta_0 + \beta_1 COMP_{it} + \beta_2 CG_{it} + \beta_3 COMP*CG_{it} + \beta_4 TENURE_{it} + \beta_5 SIZE_{it} + \beta_6 LEV_{it} + \beta_7 AUDTYP_{it} + \beta_8 SHARE_{it} + \epsilon_{it} \dots\dots\dots(3.3)$$

Where,

FRQ = financial reporting quality

COMP = executive compensation

CG = corporate governance

TENURE = executive tenure

SIZE = size of firm

LEV = leverage

AUDTYP = audit firm type

SHARE = executive shareholdings

‘it’ = the cross sectional and time series of a panel data set

μ = unobserved determinant of financial reporting quality

3.3 Variables Measurement

Table 2
Variable Measurement

Variable	Variable description	Acronym
Explained Variable Financial Reporting Quality	i. Absolute values of discretionary accruals from the modified Jones model by Kothari, Leone and Wasley (2005) were used which gives an inverse relationship with reporting quality. ii. Accrual quality measure by Dechow and Dichev (2002). The standard deviation of the residuals in the model was used to proxy financial reporting quality.	FRQ
Explanatory Variables Executive Compensation	Measured as the logarithm of CEO compensation	COMP
Corporate governance	Measured by the corporate governance index of Munisi and Randoy (2013)	CG

Control variables		
Firm size	This measured the size of a firm as the logarithm of total assets	SIZE
Leverage	Leverage is determined as the ratio of long debts to total assets. This controls for differences in capital structure	LEV
Audit type	A dummy variable was employed to measure the audit type, where Big 4 firms are represented as, '1', and '0' for non-big 4.	AUDTYP
Executive tenure	A dummy variable where a CEO serve for a period more than three (3) years it is proxied as 1 and otherwise, as 0.	TENURE
Executive share-holding	Measured as the percentage of shareholdings of CEO of listed firms.	SHARE

Source: Authors' compilation

This study employed two accrual-based measures for financial reporting quality.

i. The modified Jones model by Kothari, Leone, and Wasley (2005) is employed in this research consistent with prior research (Hassen 2014; Miko & Kamardin, 2015). This is stated in equation (3.1):

$$ACC_{it}/TA_{t-1} = \lambda_1 + \lambda_1 (1/TA_{it-1}) + \lambda_2 (\Delta REV_{it}/TA_{it-1}) + \lambda_3 (PPE_t/TA_{it-1}) + \lambda_4 (ROA_{it}/TA_{it-1}) + \epsilon_{it} \dots (3.1)$$

ACC = This is accruals computed as Net income - cash flow from operations (CFO),

TA_{t-1} = lag of total assets

PPE = gross property, plant, and equipment.

REV = difference in revenue defined as revenue_t – revenue_{t-1},

ROA = return on assets calculated as net income divided by total assets

Residual values from equation (3.1) provide the discretionary accruals (DA). This is used to proxy for reporting quality. This study employed the absolute values of the discretionary accruals which give an inverse relationship with reporting quality. Therefore, where the absolute value of discretionary accruals is high, this implies lower reporting quality. This is consistent with the study of Hassen (2014); Hope et al. (2013); Jung (2014); Krishnan (2011).

ii. Also, this study employed the accrual measure by Dechow and Dichev (2002). McNichols (2002) modified Dechow and Dichev (2002) model in two ways; Firstly, by including revenue growth to reflect the firm's performance and property, plant, and equipment which broadened the model by including depreciation (Dechow *et al.* 2010).

This is shown in equation 3.2:

$$ACC_{it} = \delta_0 + \delta_1 CFO_{it-1} + \delta_2 CFO_{it} + \delta_3 CFO_{it+1} + \delta_4 \Delta REV_{it} + \delta_5 PPE_{it} + \mu_{it} \dots (3.2)$$

Definition of variables:

ACC= This is total current accruals calculated as difference in working capital (Δ in current liabilities – Δ in current assets – Δ in cash) + changes in debt in current liabilities

CFO_{it} = current year cash flow from operations,

CFO_{it-1} = lag of cash flow from operations,

CFO_{it+1} = cash flow from operations in the following year

ΔREV = change in revenue.

PPE = property, plant, and equipment

The accruals tries to separate accruals based on firms' fundamental performance and accruals induced by manipulation in earnings (Dechow *et al.* 2010).

3.4 Estimation Technique

The multiple regression analysis was adopted in estimating the model specified. To determine the most suitable estimates between the Pooled Ordinary Least Square (OLS) and the Random/Fixed Effects, the study employed Breusch Pagan Lagragian Multiplier (BP-LM). More so, to select the suitable model between the fixed and random estimates, the Hausman test was run.

4. Results and Discussions

4.1 Summary Statistics

Table 3 reports the mean, minimum and maximum values, the number of observations of the endogenous variable (Financial Reporting Quality), and each of the exogenous variables (Executive Compensation, Corporate Governance, Interaction between Executive Compensation, and Corporate Governance, CEO Tenure, Firm Size, Leverage and Audit Type).

The result in Table 3 showed the financial reporting quality in the selected firms (measured by absolute discretionary accrual) ranges from 0.0007 to 0.9998, it has a mean value of 0.5160 with a deviation from the mean of 0.4002. While the standard deviation from the accruals of Dechow and Dichev (2002) was 0.1045, and an average value of 0.0894. Also, the log of CEO compensation (a measure of executive compensation) ranges from 5.858 million to 15.244. The average CEO's compensation is 10.840.

The table also reveals that the corporate governance of the selected firms has an average value of 29.446, this indicates the level of compliance of companies with the relevant corporate governance codes. The minimum and maximum values of the

governance index were 21 and 36 respectively. Firm size reveals a maximum and minimum value of ₦22.324 and ₦12.931 billion. Also, the size of these firms is an average ₦17.271 billion. This indicates the average size of Nigerian listed firms. The shareholdings of CEO in the firms revealed an average value of 0.013 indicating that generally, CEOs had little holdings in the company.

Financial leverage on average is 0.412 indicating that majority of the companies selected are lowly geared while the value of leverage ranges from 0 to 1.8995. CEO tenure and Audit type measured with the dummy variables ranged from 0 and 1 respectively. They revealed mean values of 0.480 and 0.693 with a deviation of 0.500 and 0.461 respectively.

Table 3
Summary Statistics

Variable	Obs	Mean	Standard Deviation	Min.	Max.
<i>Dependent Variable</i>					
FRQ: Model 1	518	0.5160	0.4002	0.0007	0.9998
Model 2	518	0.0894	0.1045	0.0415	0.8048
<i>Independent Variables</i>					
COMP	518	10.840	1.492	5.858	15.242
CG	518	29.4464	3.6363	21	36
COMP*CG	518	320.4873	66.0209	158.164	533.462
<i>Control Variables</i>					
TENURE	518	0.440	0.500	0	1
SIZE	518	17.271	2.0670	12.931	22.324
LEV	518	0.441	1.542	0	1.8995
AUDTYP	518	0.6934	0.461	0	1
SHARE	518	0.129	0.487	0	0.358

Source: Authors' Computation

4.2. Model Estimation Selection

Pre-estimation tests were carried out to determine the appropriateness of the model to be used in this research. The BP-LM Test was conducted to determine if the cross sections are similar. In addition, the Hausman test was conducted to test the consistency between the random and fixed effects model.

According to Table 4, the BP- LM Test of the Modified Jones model produced a chi-square of 21.71 with a prob-value of 0.0000, this rejects the hypothesis that the variance of the random effect is zero, depicting that the Pooled OLS model is inappropriate for the model. The Hausman test reported a chi-square of 7.45 with a *prob*-value of 0.0647 thus indicating that the null hypothesis is strongly rejected.

This was consistent with the result of Dechow and Dichev (2002) which produced a BP-LM chi-square of 148.56 (*prob*-value: 0.0000), rejecting the pooled OLS model. Furthermore, the Hausman test reported a chi-square of 36.93 (*prob*-value: 0.0000).

This reveals that the result from the fixed effect model depicts a consistent and appropriate estimate in contrast to the random effect model, therefore the results from the fixed effect estimate are interpreted to explain the relationship of CEO compensation and governance on financial reporting quality in the quoted firms in Nigeria.

Table 4
Model Selection Procedure

Model 1: Discretionary accruals Kothari et al. (2005) Breusch Pagan LM Test:			Model 2: Dechow and Dichev (2002) Breusch Pagan LM Test:		
Chi-square	prob-value	Hypothesis	Chi-square	prob-value	Hypothesis
21.71	0.0000***	Reject	148.56	0.0000***	Reject
↓			↓		
Hausman test			Hausman test		
Chi-square	prob-value	Hypothesis	Chi-square	prob-value	Hypothesis
7.45	0.0645*	Reject	36.93	0.0000***	Reject
Fixed effect model			Fixed effect model		

Note ***, ** and * denote statistically significant at 1%, 5% and 10% respectively.

4.3 Model Estimation Result

The result of the modified discretionary accruals of Kothari et al. (2005) is presented in Table 5. The coefficient of executive compensation is 0.562 (p-value = 0.000 < 0.001), implying a positive and significant relationship between executive compensation on discretionary accruals i.e., executive compensation increases discretionary accruals, thus, reducing the quality of financial reports. Corporate Governance showed a positively significant relationship of 0.252 (p-value = 0.000) on discretionary accruals. This depicts that those firm governance mechanisms have a significant effect on the quality of financial reports.

The interaction of executive compensation and corporate governance on discretionary accruals revealed a coefficient of -0.02307 (prob-value = 0.000). The result connotes a different relationship as against the separate results of the independent variables on the dependent variable. That is, executive compensation enhances reporting quality with the level of corporate governance mechanisms in the company. Also, corporate governance could improve the credibility of financial reports depending on some level of executive compensation. The result of the regression using the Dechow and Dichev (2002) measure is consistent with the result of the modified Jones model discretionary accruals, with a positive relationship of executive compensation on accruals (coeff. 0.2076, p-value = 0.005). In addition, corporate governance is found to positively influence accruals quality (coeff. 0.0487, p-value = 0.045), however, the interacting effect of executive compensation and corporate governance on accruals quality revealed a negative significant relationship with a coefficient of -0.0057 (p-value = 0.017).

Executive characteristics showed only CEO tenure revealed a significant effect on discretionary accruals of -0.077 (p -value = 0.056) using Model 1. Therefore, the increase in the tenure of a CEO indicated a positive effect on the quality of reports prepared by management. However, the second measure employed (accruals quality) revealed a significant relationship between several shareholdings of executives and firms' reporting quality with a co-efficient value of 0.7631 (p -value = 0.010).

The results of other control variables showed that firm size, leverage, and audit type are insignificantly related to discretionary accruals. While firm leverage showed a negatively significant (coeff. -0.0247, p -value = 0.000) relationship with financial reporting quality with the Dechow and Dichev (2002) measure.

4.4 Discussion of Findings

The study results revealed executive compensation that has a positive significant effect on discretionary accruals. The finding portrays that the executive incentive scheme appears to motivate opportunistic behavior concerning the preparation of the report. Also, the findings depict that managers engage in the manipulation of financial reports to enhance their compensation scheme; therefore, the quality of financial reports is negatively affected when executive compensation is increased. This finding is in support of the studies of Adeoye et al. (2021), Conyon and He (2016), Hass et al. (2016), and Zhou et al. (2018) which documented a high executive compensation served as a motivation to engage in fraudulent practices. Therefore, executive compensation is reduced to curb manipulations or false reports. The studies showed that equity incentives led to higher corporate fraud while cash-based compensation had a negative yet significant impact on the propensity to commit corporate fraud. However, this contradicts the evidence shown by Armstrong *et al.* (2013), Hassen (2014), and Sun (2014) who upheld the pay-for-performance scheme.

Corporate governance which serves as a monitoring mechanism employed to mitigate the excesses of management revealed a significantly positive effect on discretionary accruals. The result connotes that corporate governance mechanisms employed do not enhance the quality of the financial report. Besides, compliance with the corporate governance code was documented to be high, however, it is found to reduce reporting quality. However, the interactive effect of executive compensation and corporate governance revealed a significant negative effect on discretionary accruals which indicates an enhanced reporting quality. The interaction indicates that executive remuneration could improve reporting process and quality with the presence of corporate governance mechanisms while corporate governance in association with a well-structured executive compensation also increases the quality of financial reports. Therefore, this result supports the agency theory that executive compensation could be employed to

ensure shareholders' interests are met, thus curbing information asymmetry. More so, corporate governance mechanisms serve as monitoring systems in the firm ensuring the achievement of the firm's goals. Executive compensation and corporate governance mechanisms might not achieve quality financial reports independently as found in the estimation results.

Hence, the interaction of these variables ensures that executive compensation with a greater extent of corporate governance structure enhances financial reporting quality. Also, governance mechanisms depending on executive compensation improve the quality of financial reports.

Concerning control variables, CEO tenure and shareholdings revealed a significant impact on reporting quality indicating that the period of appointment of an executive in a firm positively influences the quality of the report prepared. This supports the notion that the longer an executive stay in a company, he/she is familiar with the reporting process, thus, can ensure that true and fair reports are published. Also, managerial shareholdings may serve as an incentive to also align shareholders' goals and enhance firm performance. This is tandem with the studies of Hass *et al.* (2015); and Jayaran and Milbourn (2012), where it was noted that the tenure of an executive director in a company is an indication of the executive power in decision-making which can be used to influence the financial reports. This is contrary to the findings of Conyon and He (2016), Huang *et al.* (2012), and Johnson *et al.* (2009) where it was argued that the tenure of a CEO enhances the probability of manipulations in the financial reports through collaboration with other employees.

The estimates revealed that firm leverage is significant to firms' reporting quality. The result concludes that firm debt structure does influence reporting quality. This study provides evidence similar to the findings of Al-Asiry (2017), Armstrong *et al.*, (2013), Choi and Pae, (2011), Mahboub, 2017, Istianingsih (2021), and Zhou *et al.* (2018) who found that firms' debt may influence earnings management.

Other variables, audit type, and firm size have a non-significant relationship with financial reporting quality. The result from the size of the firm may arise from the complex financial reporting process from large transactions in large firms. Audit firm assume that the Big 4 audit firm have more resources and expertise in limiting managers' manipulative reporting behavior. However, this study found a contrary result revealing an insignificant effect, this means the audit firm engaged does not influence the quality of financial reports produced.

Table 5
Model Results

Dependent variable FRQ	Model 1: Discretionary accruals Kothari et al. (2005)		Model 2: Dechow and Dichev (2002)	
	coeff.	prob-value	coeff.	prob-value
Independent variables				
COMP	0.5615	0.000***	0.2076	0.005***
CG	0.2515	0.000***	0.0487	0.045**
COMP*CG	-0.0231	0.000***	-0.0057	0.017**
Control variables				
TENURE	-0.0765	0.056*	-0.0100	0.470
SIZE	0.0215	0.145	0.0131	0.402
LEV	-0.0194	0.130	-0.0247	0.000***
AUDTYP	-0.0290	0.530	0.0410	0.335
SHARE	0.1494	0.717	0.7631	0.010***
Model Stat.				
R ² Within	0.127		0.1068	
F. Stat./Wald Chi ²	1.51	0.016	5.71	0.000

Source: Authors' Computation

Note ***, ** and * denote statistically significant at 1%, 5% and 10% respectively.

5. Conclusion

This study examined the influence of executive compensation and corporate governance on financial reporting quality. The results of this study contribute to the existing and growing literature on executive compensation, corporate governance as well as financial reporting quality. The study employed an index as a measure of corporate governance rather than individual mechanisms in past studies. Specifically, the study showed the interaction of executive compensation and corporate governance had a positive and significant effect on the financial reporting quality of Nigerian firms. Therefore, this study recommends the following:

- i. Executive compensation should be constantly reviewed to ensure its consistency with firms' objectives. Also, while setting performance targets, proper care should be taken on targets that tend to motivate financial reports' manipulations.
- ii. Corporate governance mechanisms especially the board of directors are advised to be actively involved in the monitoring reporting process to enhance quality financial reports.

- iii. There are various corporate governance codes established by regulatory bodies in Nigeria, it is advised that these governance codes be harmonized to eliminate complications in adoption by firms.

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