



FIRM CHARACTERISTICS AND DISCRETIONARY CASH FLOW IN LISTED OIL AND GAS FIRMS IN NIGERIA

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Abstract

The increasing prevalence of earnings management in Nigerian companies indicates that this practice is quickly becoming a significant issue for stakeholders. Discrepancies in accounting data are concerning, and the poor quality of financial reporting and accounting data is leading to growing doubts about the accuracy and usefulness of the information provided in financial reports. Consequently, this study focused on the relationship between firm characteristics and discretionary cash flow in listed oil and gas firms in Nigeria. A longitudinal research approach was employed on a population comprising of the 12 oil and gas companies that were listed as of the last quarter of 2021 on the Nigerian Exchange Group (NGX). The study adopted secondary data from the 2002–2021 annual reports of oil and gas companies listed on the Nigerian Exchange Group while the Pooled Ordinary Least Square (OLS) regression analysis was deployed as the method of data analysis. The findings revealed that discretionary cash flow and the firm characteristics of oil and gas firms have a negative significant relationship. Based on the above findings, this study concluded that an abundance of operating cash flow lessens the propensity to participate in earnings management. The study therefore recommended that companies listed on the Nigerian Exchange Group (NGX) should abide by the governance reforms already in place in the nation, such as sufficient assessment, investigation, and scrutiny of the company's financial statement and sufficient protocols for the early identification of earnings management practices.

Keywords: *Discretionary cash flow, Firm characteristics, Income manipulation, Nigeria exchange group, and Oil and gas firms.*

JEL Classification: M41; L2; Q40

INTRODUCTION

In Nigeria, the oil and gas sector is a key player in economic growth. According to the Central Bank of Nigeria (CBN, 2020), around 90% of the country's foreign exchange revenue comes from this industry. Despite its importance, the operations of the industry have been associated with allegations of scandalous financial practices, such as funds not being transferred to the federation

account, and excessive spending of earnings by the Nigerian National Petroleum Corporation (NNPC). Similar claims are linked to Nigerian listed oil and gas marketing firms, such as the case of African Petroleum (Forte Oil) Plc, where the company's financial statements failed to disclose a credit facility of 24 billion naira (Ibrahim & Abubakar, 2019). It is noteworthy that a Big 4 audit firm was overseeing this significant omission; a firm that is meant to prevent such fraudulent practices. This raises concerns about the potential for serious earnings manipulation in this industry.

There are specific corporate characteristics with different accounting details recorded by the organization in its financial statements for a given financial year, which can trigger a message to several owners of the business about its results. Miloud (2022) posited that firm characteristic consists of structure, capital, and market-related structures. The structures related are firm size, ownership and firm age. These market-associated structures include environmental uncertainties, industry type and the immediate marketing environment while the capital-related structures include liquidity and capital intensity (Aribaba, *et al.*, 2023).

Earnings manipulations has evolved globally in terms of practice, complexity, language, and form. In the early 1990s, it was widely acknowledged as one of the main difficulties of financial reporting by both national and international regulators. Musa, Abdul Latif and Abdul Majid (2023), affirmed that managers were discovered to have exercised discretion in financial reporting and direct dealings to alter financial statements for the purpose of earnings management, either by manipulating contractual terms dependent on reported accounting or by deceiving specific stakeholders about the company's true economic performance, according to statistics. The objective of financial reporting is to provide information about a company that can help a range of users make financial decisions. Yet, because of the potential impact of earning management on the information contained in these reports, a lot of people who read company financial reports have questioned the usefulness of this objective. Thus, the confidence placed on accounting and auditing functions is threatened by earnings management's developing issue. (Abdullahi & Ibrahim, 2017). To address this incidence of manipulation of financial reports, the Nigerian Security and Exchange Commission (SEC) initiated some reforms in 2011. According to Kim, Fujiyama and Koga (2024) the reforms include the mandatory adoption of International Financial Reporting Standards (IFRSs) for all listed firms which focuses on improved disclosure of information in financial reports. In Nigeria, adherence to the requirements of the pertinent laws, guidelines, and IFRSs in financial transactions and reporting is expected of all corporate organizations. So, if there are hints of earnings manipulation which could cause companies' corporate failure, it would be flagged.

This study acknowledges the potential consequences of earnings management, including financial scandals, and the dishonest and deceptive nature of its concealment. However, the extent to which firm characteristics like age, size, composition of the board, and auditor firm size influence earnings management is still unknown, particularly for Nigerian-listed oil and gas companies. In the existing research, there have been conflicting opinions and ambiguous results on the effect of firm characteristics on discretionary cash flow. Therefore, it's critical to assess the effect of firm characteristics such as firm age, firm size, composition of the board, and size of the audit firm on listed oil and gas companies' earnings management proxied by discretionary cash flow.

Research Hypothesis

Ho: There is no significant relationship between firm characteristics and discretionary cash flow in listed oil and gas firms in Nigeria.

LITERATURE REVIEW

Firm Characteristics

The phrase "firm characteristics" encompasses a variety of elements, including ownership, financial leverage, size, age, nationality, gender, and education. Firm characteristics, according to Loyd (2023), are how ethnic distinctions are represented on boards that reflect people's social and cultural identities. It can also be described in a professional or commercial context, where social and cultural identity relate to individual memberships in groups that significantly influence major life events for individuals. These associations involve, and not restricted to, gender, race, national origin, religion, age group, size, financial power, ownership, and area of expertise in the workplace. Age, race, and ethnicity are the primary categories of company characteristics; education, experience, income, and marital status are the subsidiary categories (Ghosh & Ansari, 2018).

Earnings Management

Earnings management, as defined by Wagener (2024); Aljughaiman, Nguyen, Trinh and Du (2023), involves using managerial discretion in transaction structuring and financial reporting to manipulate financial reports, either to misrepresent the company's true economic performance to specific stakeholders or to influence contractual outcomes based on reported accounting figures. Therefore, based on this definition, earnings management is not always said to be wrong, there have also been arguments in favour of it (Rudra & Bhattacharjee, 2021). According to Ojo, Oyedokun and Ugoh (2020), there is a benefit to earnings management, and it may be used as a tool to tell the market about insider information, which helps the share price more accurately reflect the company's future.

The accounting community has also come to terms with the fact that not all methods of earnings management are dishonest. However, norm setters, regulators, and accountants concur that earnings management is destructive and counterproductive. It deceives investors and diminishes the credibility of financial reporting. Burdeos (2021) defined, earnings management as the deliberate manipulation of earnings to achieve a predetermined goal. The main way to manage earnings is through management actions that facilitate the use of generally available accounting options to help reach targeted earnings levels through operating decisions and generally accepted accounting principles (GAAP). As a result, standard-setters and the accounting profession are deeply worried about the harmful impact of earnings management on financial reporting.

Discretionary Cashflow

Discretionary cash flow is a significant topic in accounting and finance literature. Kieso, Weygandt and Warfield (2020) introduced the concept of "discretionary cash flow," which represents the cash remaining after investments in projects, capital expenditures, and dividends. This concept plays a crucial role in cash flow analysis by quantifying available cash after covering costs. Analyzing cash flow involves tracking money coming in and going out; a surplus indicates the

entity's potential for generating returns, provided it is not due to borrowing. Cash flow analysis is vital for assessing liquidity and profitability. Discretionary cash flow is calculated as net cash flows from operations minus capital expenditures and cash distributions, indicating excess funds for future use in various aspects of the business. Stakeholders often rely on discretionary cash flow estimates to inform their investment decisions, making it a key measure of company success.

Firm Age

The maturity of firms is often defined by their age. The duration of a being or thing's existence is its age. Wu, Dluhošová & Zmeškal (2023), posited that firm age is measured in years when the company was founded. Listing age is economically significant as listing marks a defining moment in the company's life. The number of years a corporation has been incorporated serves as a proxy for its age. Long-standing companies typically have lower degrees of earnings management than recent arrivals. Reputable businesses are well-known, have a high market value, and must maintain their good name. (Saleh, Afifa, & Haniah, 2020).

Board Composition

The board of directors is often considered the primary internal control mechanism among the set of corporate governance mechanisms, with the responsibility of monitoring top management and protecting shareholders' interests. Kabiru, Iliya and Abdulkadir (2023) argued that the board of directors is a "market-induced institution, the ultimate internal monitor of the set of contracts called a firm, whose most important role is to scrutinize the highest decision-makers within the firm." It is the directors' responsibility to ensure that financial statements are prepared according to approved accounting standards (Saleh & Islam, 2020).

Firm Size

The size of a firm has a significant impact on the quality of reported information. Soyemi and Olawale (2019); Nguyen, Kim and Ali (2024) argued that larger firms have lower information asymmetry due to strong governance and control, leading to a reduction in earnings management practices. However, being a large firm is not enough to ensure a strong level of corporate governance and reduce earnings management practices. For example, Enron's fall was mainly due to the failure of corporate governance, specifically a board problem due to blindly trusting auditors and allowing a conflict of interest to take place. Additionally, according to agency theory, larger firms experience greater agency costs, leading to more opportunistic practices (Kamath, 2019).

Audit Firm Size

Previous research has paid a great deal of attention to the differences in audit quality offered by Big Firms and non-big audit firms. Most auditing studies divide audit firms into two categories: non-large firms and big 4 firms. Large audit firms are thought to be respectable and prestigious, which leads to their high standard of audit quality. The Big 4 auditors are more independent since they have more clients, which means that their revenue streams are not impacted by any one customer, allowing them to maintain a high level of audit quality. Alshare, Kadir, Kamarudin & Hassan, 2023 reported that there is a good chance the audit company's revenue is mostly derived from the audit charge if both the audit firm and the client are small business. In the Nigerian context, qualitative analysis and reporting of firm characteristics are generally favored over quantitative analysis. Therefore, this study focuses exclusively on the quantitative analysis of firm characteristics and their influence on earnings management of listed oil and gas firms in Nigeria.

The specific variables examined in this study are audit firm size, firm age, board composition, and firm size.

Theoretical Review

The agency theory was utilized as the theoretical background for this study to develop an empirical framework for assessing the impact of firm characteristics on earnings management proxied by discretionary cashflow in listed oil and gas firms in Nigeria. The agency theory is based on the relationship between the principal (owners) and the agent (managers). The separation of ownership from management in modern corporations provides the context for the function of agency theory. Modern organizations have widely dispersed ownership, in the form of shareholders, who are not normally involved in the management of their companies. In these instances, an agent is appointed to manage the daily operations of the company. This distinction between ownership and control creates the potential for conflicts of interest between agents and principals (Lacy-Nichols, 2023; Chen, Wang & Wang, 2023).

According to Dogru, Kizildag, Ozdemir and Erdogan (2020), the state of free cash flow may cause problems for organizations that are seeking to support their company operations as well as expansion, as managers may not exhibit profit-maximizing behavior but rather use increased free cash flow to achieve personal goals (Lai, Latiff, Keong & Qun, 2020). However, various factors, such as the composition of the board, the size of the audit firm, the age and scale of the company, can affect the likelihood of manipulating earnings. These characteristics are instrumental in shaping investors' trust in a company's financial performance, especially regarding the reliability of its earnings. For example, a well-diversified board and collaboration with a prominent audit firm such as the Big 4 can influence how shareholders perceive the trustworthiness of a company's financial disclosures. In addition, the transparency of a company's financial reporting practices plays a crucial role in maintaining investor confidence. Clear and comprehensive disclosure of financial information, including detailed explanations of accounting methods and assumptions, can help mitigate concerns about potential earnings manipulation.

Empirical Review

Research was conducted by Egbunike and Odum in 2018 to examine the relationship between board leadership structure and earnings quality of Nigerian manufacturing companies listed on the stock exchange. According to the findings, the size and composition of the board had a significant and positive impact on earnings quality. However, the research also indicated that while CEO duality was positively and significantly associated with earnings quality, non-executive directors had a negative correlation with it.

Using data from China, Chen, Cheng, Hao and Liu (2020) investigated if and how government incentives to increase GDP growth impact firm-level earnings management. It was discovered that companies in target provinces or those with GDP growth incentives are more prone than those in other provinces to manipulate results. They discovered, specifically, that these companies have a higher propensity to overproduce, inflate their revenues, and postpone their asset impairment losses. These are the three main ways that corporate accounting numbers can influence the GDP computation; for this reason, GDP growth must be controlled using the natural log of the total gross domestic product, adjusted for inflation.

Contrary to previous assumptions, Orbunde, *et al.*, (2020) found a positive and substantial relationship between audit firm size and earnings management. The findings suggested that an audit firm size cannot hinder the earnings management techniques of Nigerian publicly traded consumer companies. According to preconceived notions, audit firm size is negatively related to earnings management since large audit firms have greater resources to undertake high-quality audits than small audit firms. Furthermore, large audit firms have a vast client base, making them less reliant on any single client, which could jeopardize audit quality. Large audit firms invest more in their reputation than smaller audit firms do, and if they are proven to have compromised audit quality, their reputation will be jeopardized. Based on the findings, the alternative hypothesis that audit firm size has a significant impact on the earnings management of listed consumer goods in Nigeria is accepted and the null hypothesis that audit firm size has no significant impact on the earnings management of listed consumer goods companies in Nigeria is rejected.

Mohamed, Hazem, and Ahmed (2020) analyzed a UK dataset to study the link between CEO/CFO equity incentives and earnings management. They found CEO equity incentives relate to increased earnings manipulation, while CFO incentives showed no significant link. Governance quality did not affect this relationship, suggesting wealth-driven incentives for earnings manipulation persist despite governance efforts. Also, Kalantonis, Schoina, and Kallandranis (2021) studied board composition impact on earnings management using two models on firms from 2008 to 2016. CEO duality had no effect. Greek firms were significantly affected by the financial crisis. Compliance with International Accounting Standards improved over the past decade.

Khuong, *et al.*, (2022) used income data to predict future incomes. Earnings quality is linked to performance. Earnings management (EM) influences earnings persistence (EP). Generalized method of moments (GMM) regression on 228 Vietnamese companies from 2014 to 2017 showed accrual earnings management (AEM's) negative association with EP and real earnings management (REM's) mixed association. Boards of directors (BODs) play a crucial role in EP. This research informs future studies and offers practical options for governance and business management. Moreso, Hoang and Khuong (2023) findings indicated that audit quality, as measured by Big 4 audit firm or non-Big 4 audit firm, had no statistical significance with discretionary cashflow. This is inconsistent with the earlier research by Piot and Janin (2007), which found no distinction in actual earnings management mitigation between Big 4 and non-big 4.

Based on the review of previous research, firm characteristics proxied by firm age, firm size, board composite and auditor firm size can be used to determine the effect earnings management practices in listed oil and gas firm in Nigeria.

METHODOLOGY

Utilizing secondary data from the 2002–2021 annual reports of oil and gas businesses listed on the Nigerian Exchange Group, the study used a longitudinal research design. The Population of the Study consists of the 12 oil and gas companies that were listed as of the last quarter of 2021 on the Nigerian Exchange Group (NGX). These companies operate in the downstream sector of the oil and gas industry. The 12 oil and gas businesses that were listed on the Nigerian Exchange Group (NGX) as of the final quarter of 2021 make up the study's population. These businesses are involved in the oil and gas industry's downstream sector. Nine of the twelve organizations were

chosen for the study using a simple random sample technique. The secondary data that was used came from annual reports that the listed oil and gas businesses filed with the Nigeria Exchange Group. The study's duration spans from 2002 to 2021. The study covered 20 years from 2002 to 2021, due to incomplete data or unavailable financial report. and content analysis was used to generate the data for the variables. In this work, pooled ordinary least square (OLS) regression analysis was used as the data analysis approach.

RESULTS AND DISCUSSIONS

Presentation of Data

Effects of Firm Characteristics on Discretionary Cash flows

Discretionary cash flow is another proxy for earnings management. This part of profits management deals with the excess money that, once all capital projects have been completed and necessary expenditures, including salaries, have been made, can be utilized to pay cash dividends, bonuses to staff, repurchase common shares, and settle investor debt.

The statistical properties of the model are presented in the Table below. The variation in discretionary cash flow explained by the explanatory variables (firm characteristics variables and other catchall variables considered in the model) is 88%.

OBSERVATION	180
R-SQUARED	0.91
ADJUSTED R-SQUARED	0.88
DURBIN-WATSON STAT	2.38

This indicates that only 12% of the total variation in discretionary cash flow is not captured by the regressors. Therefore, the model exhibits a good fit and the question about possible spurious regression does not arise. The value of the Durbin-Watson statistic (2.38) falls within the appropriate range, ensuring the absence of serial correlation.

The cross-section dependence of residuals, as captured by Breusch-Pagan LM, Pesaran Scaled LM, and Pesaran CD, all indicate that the model does not show any evidence of the interdependence of residuals across oil and gas firms.

Cross Section Dependence of residuals

Breusch-Pagan LM	1.62	0.19
Pesaran scaled LM	1.29	0.92
Pesaran CD	0.10	0.83

This is supported by the probability values associated with the F-distribution of each of the statistics, which are greater than 10%, indicating that the null hypothesis of no cross-section dependence is not rejected.

Similarly, cross-section heteroscedasticity returns statistical values in favour of no variance dependence across oil and gas firms in Nigeria.

Cross Section Hetero

Breusch-Pagan LM	1.62	0.12
Pesaran scaled LM	1.29	0.72

Pesaran CD	1.10	0.82
<i>Period Hetero</i>		
Breusch-Pagan LM	0.62	0.91
Pesaran scaled LM	1.29	0.94
Pesaran CD	0.10	1.44

Based on this report of the diagnostic tests, the estimation technique employed for the model is valid and, by implication, precision, inference, and prediction can be inferred from the results. The findings are also reliable for drawing important policy implications regarding earnings management in the Nigerian oil and gas sector.

Table 1: Panel OLS results showing firm characteristics effect on earnings management. Discretionary Cashflows

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FAGE	-0.941***	0.16	-5.76	0.00
AUFSIZE	-0.304*	0.16	-1.87	0.08
BODCOMP	0.716***	0.05	13.46	0.00
FSIZE	-3.563**	1.499	-2.376	0.02

Note: *, **, *** indicates significant at 10%, 5% and 1% respectively;

Independent variables: FAGE AUFSIZE BCOMP FSIZE indicates Firm Age, Audi Firm dichotomous, Board Composition, Firm size. Control variables:

Source: Author's computation using EViews 12 (2023)

Starting with firm age, as the oil and gas firm ages in Nigeria, discretionary cash flow decreases. An additional year of age for an oil firm resulted in a 0.9% reduction in discretionary cash flow. Audit dichotomous also showed a negative insignificant effect (coefficient of -0.304 and Prob. of 0.08). A unit increase in the activity of the Big 4 leads to a 0.3% decrease in discretionary cash flow. Although the effect is relatively small, the fact that audit dichotomous reduced discretionary cash flow suggests that the involvement of Big 4 auditors limits the inclination to practice earnings management through cash flow discretion.

Firm size reduced discretionary cash flow by 3.5% for a 1% increase. This significant magnitude indicates that discretionary cash flow is highly responsive to changes in the assets of oil and gas firms in Nigeria. An increase in assets of a company with large assets leads to a decrease in discretionary cash flow, while a reduction in assets of a company with small assets results in more discretionary cash flow.

Board composition influences discretionary cash flow by approximately 0.72% for a 1 percentage change. A 10% increase in the board composition of the Nigerian oil and gas sector results in an approximate 7.2% increase in discretionary cash flow. A one-unit increase in the non-executive/independent directors in the board size leads to approximately a 0.72% increase in discretionary cash flow. Board composition of Nigerian oil and gas firms does not act to reduce discretionary cash flow but rather facilitates it.

Restatement of Hypothesis

To relate these results to the hypothesis of this study, the null hypothesis is that firm age, board composition, firm size, and audit firm size do not have a significant effect on earnings management. Results from the discretionary cash flow, a proxy for earning management, reject the null hypothesis for all firm characteristics. However, only board composition has a positive and significant effect, while others have a negative but significant effect.

Discussion of Findings

The purpose of this research was to ascertain the effect of firm characteristics on discretionary cash flow, and the hypothesis maintains that there is no significant relationship between firm characteristics and discretionary cashflow. The finding of a negative significant relationship between firm age and discretionary cash flow suggests that as a company ages, its abnormal cash available for investor withdrawal decreases. This could be attributed to the accumulation of more experience and management decisions to reduce the practice of managing earnings via discretionary cash flow as the firm matures. A negative, negligible influence was also revealed by the dichotomous audit company size. This suggests that companies using one of the Big 4 auditors in the Nigerian oil and gas industry are more likely to have lower levels of earnings management. Furthermore, it can be inferred that there is a less pronounced presence of agency problems in this context.

There was discovered to be a strong positive correlation between board composition and discretionary cash flow. This suggests that a higher proportion of non-executive/independent directors in Nigeria's oil and gas industry improves earnings management using discretionary cash flow. This runs counter to the findings of Fodio, Ibikunle, and Oba (2013), who showed that a lower degree of accrual management is a result of board independence, indicating the significance of board independence in raising board vigilance. This analysis predicts that firms with more independent board members are more likely to scrutinize managers for earnings manipulation, resulting in a negative link between discretionary cashflow and board independence.

Firm size has a negative significant relationship with discretionary cash flow. This implies that discretionary cash flow is highly responsive to changes in the assets of oil and gas firms in Nigeria. An increase in assets of a company with large assets leads to a decrease in earning management using discretionary cash flow, while a reduction in assets of a company with small assets results in more discretionary cash flow. This suggests that firms with large asset bases are less likely to practice earnings management compared with firms with small asset bases, an increase in assets may likely elevate capital gains and compensations for the Directors, making management less likely to engage in discretionary cash flow. However, a decrease in assets may lead to a fall in capital gains and compensation, potentially triggering agency problems that favor discretionary cash flow to compensate for any loss in investor transaction obligations. This is congruent with the findings of Fodio, Ibikunle, and Oba (2013), who discovered a substantial negative relationship between business size and discretionary cashflow, implying that larger firms are less involved in earnings management. Smaller companies may engage in earnings management to display appealing bottom lines and attract more customers.

CONCLUSION AND RECOMMENDATION

The study looked at how firm characteristics influenced discretionary cash flow in Nigerian listed oil and gas companies. The findings revealed that there is a substantial negative association between discretionary cash flow and firm characteristics in oil and gas firms. Only the makeup of the board, however, has a considerable and beneficial impact; the others have a significant but unfavorable impact. An abundance of operating cash flow lessens the propensity to participate in earnings management. The outcome can be trusted when formulating significant rules for managing earnings in the Nigerian oil industry. As a result, the study recommended that companies listed oil and as firms should adhere to the nation's existing governance reforms, such as adequate assessment, investigation, and scrutiny of the company's financial statements, as well as adequate protocols for early detection of earnings management practices. The Company and Allied Matters Act, the International Financial Reporting Standards, and other financial reporting Acts should all be strictly enforced and monitored by the Financial Reporting Council of Nigeria (FRCN).

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