

Board independence and financial reporting quality: Evidence from consumer goods firms in Nigeria

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Abstract

This study investigates the relationship between board independence and financial reporting quality among consumer goods firms listed on the Nigerian Stock Exchange (NSE). Using a panel dataset from 2016 to 2023, we measure board independence through the proportion of non-executive directors and financial reporting quality using accrual-based metrics such as discretionary accruals. The results reveal a statistically significant positive relationship between board independence and financial reporting quality. Firms with higher proportions of independent directors exhibit lower earnings management, greater transparency, and higher reliability in financial disclosures. These findings carry implications for corporate governance reform in emerging markets, particularly Nigeria's consumer goods sector.

Keywords: Board Independence, Financial Reporting, Nigeria.

INTRODUCTION

High-quality financial reporting is fundamental to the efficient functioning of capital markets, as it enhances transparency, reduces information asymmetry, and supports informed economic decision-making. Financial statements constitute a primary source of information for investors, regulators, creditors, and other stakeholders in assessing a firm's financial performance, position, and future prospects (IASB, 2018). When financial reports are reliable and faithfully represent economic reality, they contribute to market confidence, efficient capital allocation, and overall financial stability (Bushman & Smith, 2001).

Despite its importance, the quality of financial reporting remains a persistent concern in many emerging economies, including Nigeria. Weak institutional frameworks, inadequate enforcement of accounting standards, and governance deficiencies have been linked to recurring cases of financial misstatements, earnings manipulation, and corporate failures (Okike, 2007; World Bank, 2020). In Nigeria, several high-profile corporate scandals have raised doubts about the credibility of published financial statements and exposed vulnerabilities in corporate oversight structures. These challenges have intensified calls for stronger governance mechanisms capable of improving financial reporting integrity and restoring investor confidence.

Corporate governance has therefore assumed a central role in contemporary discussions on financial reporting quality. Prior literature identifies the board of directors as a critical internal governance mechanism responsible for monitoring management, overseeing financial reporting processes, and safeguarding shareholders' interests (Fama & Jensen, 1983). An effective board is expected to constrain opportunistic managerial behavior, particularly earnings management practices that distort reported financial performance (Dechow, Ge, & Schrand, 2010). Consequently, the composition and independence of the board have become focal points in governance reforms across both developed and developing economies.

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Among board characteristics, board independence has received considerable scholarly and regulatory attention. Independent directors, defined as non-executive directors without material relationships with the firm, are presumed to possess the objectivity and autonomy necessary to challenge management decisions and enhance oversight (Jensen & Meckling, 1976). Empirical evidence from prior studies suggests that boards with a higher proportion of independent directors are more effective in monitoring financial reporting, reducing earnings manipulation, and improving disclosure quality (Beasley, 1996; Klein, 2002). As a result, corporate governance codes across jurisdictions increasingly emphasize board independence as a cornerstone of accountability and transparency.

In Nigeria, regulatory bodies such as the Financial Reporting Council and the Securities and Exchange Commission have incorporated board independence requirements into governance codes, reflecting global best practices. However, the effectiveness of these provisions remains subject to debate, particularly in contexts characterized by concentrated ownership, family control, and social ties among board members (Adegbite, 2015). These structural features may weaken the actual independence of boards, thereby limiting their ability to enhance financial reporting quality despite formal compliance with governance codes.

The Nigerian consumer goods sector presents a particularly relevant context for examining the relationship between board independence and financial reporting quality. The sector plays a vital role in economic growth, employment generation, and industrial development, while also attracting substantial domestic and foreign investment. Consumer goods firms operate in highly competitive environments marked by rising production costs, volatile exchange rates, and strong earnings expectations from investors. These pressures may increase managerial incentives to engage in earnings management in order to meet performance targets or sustain market valuation (Healy & Wahlen, 1999).

Furthermore, consumer goods firms tend to have high public visibility and frequent interactions with regulators, auditors, and capital market participants. As such, the credibility of their financial reports is crucial not only for firm-level decision-making but also for broader market confidence. Examining how board independence influences financial reporting quality within this sector provides valuable insights into the effectiveness of governance mechanisms in mitigating reporting risks in emerging markets.

Against this backdrop, this article explores the nexus between board independence and financial reporting quality in Nigerian consumer goods firms. By situating the discussion within established corporate governance theories and prior empirical evidence, the study contributes to the ongoing debate on the role of independent boards in enhancing transparency and accountability in emerging economies.

Concept of Board Independence

Board independence refers to the degree to which a company's board of directors is composed of non-executive directors who are free from management influence and do not maintain material, financial, or personal relationships with the firm, its executives, or controlling shareholders beyond their board appointments. Independent directors are presumed to possess the autonomy and objectivity required to exercise unbiased judgment in monitoring management actions and protecting shareholders' interests (Fama & Jensen, 1983). The essence of board independence lies in the board's ability to function as an effective oversight mechanism rather than a symbolic extension of executive authority.

The concept of board independence is deeply rooted in **agency theory**, which highlights the separation between ownership and control in modern corporations. According to Jensen and Meckling (1976), managers may pursue personal objectives that conflict with shareholders' interests, particularly when monitoring mechanisms are weak. Independent directors are therefore appointed to mitigate agency conflicts by supervising management, evaluating strategic decisions, and ensuring the credibility of financial reporting processes. Their

independence enhances their willingness and capacity to challenge managerial decisions, especially in areas prone to opportunistic behavior such as earnings management and financial disclosures.

Beyond agency theory, **resource dependence theory** provides additional justification for board independence. Independent directors often bring diverse expertise, external networks, and reputational capital that can enhance board effectiveness and corporate legitimacy (Pfeffer & Salancik, 1978). Their external perspectives reduce information asymmetry and strengthen board deliberations, particularly on complex accounting and financial reporting matters. Similarly, **stakeholder theory** suggests that independent directors play a broader governance role by protecting the interests of non-shareholder stakeholders, including creditors, regulators, and the public, through improved transparency and accountability (Freeman, 1984).

From a regulatory perspective, board independence has become a central feature of corporate governance reforms worldwide. Governance codes in developed economies, such as those in the United Kingdom and the United States, emphasize the importance of independent directors in ensuring effective board oversight and financial reporting integrity. These global best practices have influenced governance reforms in emerging economies, including Nigeria, where regulators increasingly view board independence as essential for improving corporate accountability and investor confidence.

In Nigeria, the **Nigerian Code of Corporate Governance (NCCG)** underscores the importance of board independence by recommending the inclusion of a sufficient number of independent non-executive directors on corporate boards. The Code emphasizes that independent directors should be free from relationships that could impair their objectivity and should possess the requisite skills, experience, and integrity to discharge their oversight responsibilities effectively (Financial Reporting Council of Nigeria, 2018). Independent directors are specifically tasked with monitoring management performance, overseeing the financial reporting process, ensuring compliance with applicable accounting standards, and strengthening internal control systems.

The relevance of board independence is particularly pronounced in environments characterized by weak institutional enforcement and concentrated ownership structures, such as Nigeria. Prior studies indicate that in such contexts, boards are often dominated by executive directors, family members, or affiliated individuals, which undermines effective monitoring (Okike, 2007; Adegbite, 2015). The presence of truly independent directors can counterbalance managerial dominance and reduce the likelihood of collusion between management and the board in manipulating financial reports.

However, the effectiveness of board independence depends not only on formal compliance with governance codes but also on the **substance of independence**. Scholars argue that nominally independent directors may still be influenced by social ties, political connections, or prolonged tenure, which can compromise their objectivity (Westphal & Zajac, 2013). In Nigeria, cultural norms and relational networks may further weaken the actual independence of directors, raising concerns about whether board independence requirements translate into meaningful oversight.

Despite these challenges, empirical evidence suggests that higher levels of board independence are associated with improved financial reporting quality, reduced earnings management, and stronger disclosure practices (Beasley, 1996; Klein, 2002). Independent directors are more likely to support rigorous audit processes, demand greater transparency, and engage external auditors effectively, thereby enhancing the reliability of financial statements. Their presence also signals a firm's commitment to good governance, which can improve market perception and investor confidence.

In the context of Nigerian consumer goods firms, board independence assumes additional significance due to the sector's exposure to market pressures, public scrutiny, and regulatory oversight. Independent directors in these firms play a crucial role in balancing performance expectations with ethical reporting practices, ensuring that financial statements reflect economic reality rather than short-term managerial interests. Consequently, board independence remains a vital governance mechanism for strengthening financial reporting quality and promoting sustainable corporate performance in Nigeria.

Financial Reporting Quality

Financial reporting quality refers to the extent to which a firm's financial statements provide a true, fair, and faithful representation of its underlying economic performance and financial position. High-quality financial reports enable users to accurately assess a firm's profitability, risk profile, and future cash flow prospects, thereby supporting efficient contracting and capital allocation decisions (Bushman & Smith, 2001). The conceptual framework for financial reporting emphasizes qualitative characteristics such as relevance, faithful representation, comparability, verifiability, timeliness, and understandability as the foundations of reporting quality (IASB, 2018).

Relevance ensures that financial information is capable of influencing users' decisions, while faithful representation requires that reported figures are complete, neutral, and free from material error. Comparability allows users to identify similarities and differences across firms and over time, thereby enhancing the usefulness of financial statements in performance evaluation. Transparency, which underpins these qualitative characteristics, reduces information asymmetry between corporate insiders and external stakeholders and strengthens market confidence (Healy & Palepu, 2001).

From an accounting perspective, financial reporting quality is often assessed through the absence or minimization of **earnings management**, which occurs when managers use judgment in financial reporting to alter reported earnings in order to mislead stakeholders or influence contractual outcomes (Healy & Wahlen, 1999). Earnings management may take the form of discretionary accruals, real activities manipulation, or classification shifting, all of which distort the informational value of reported earnings. Persistent earnings management undermines the credibility of financial reports and weakens investor trust in capital markets.

Low financial reporting quality may also manifest through financial misstatements, delayed disclosures, and selective reporting practices that obscure a firm's true financial condition. Such practices are often associated with weak internal controls, ineffective board oversight, and inadequate audit quality (Dechow, Ge, & Schrand, 2010). In extreme cases, poor reporting quality can culminate in corporate failures and systemic market disruptions, as evidenced by historical financial scandals globally.

The challenges associated with financial reporting quality are particularly pronounced in **emerging markets**, where institutional environments tend to be less developed. Weak regulatory enforcement, limited investor protection, and high levels of ownership concentration increase the likelihood of opportunistic reporting behavior (La Porta et al., 1998). In such contexts, controlling shareholders and managers may dominate decision-making processes, reducing transparency and increasing the risk of financial manipulation. These structural weaknesses often limit the effectiveness of accounting standards alone in ensuring high-quality financial reporting.

In Nigeria, concerns over financial reporting quality have persisted despite the adoption of International Financial Reporting Standards (IFRS). While IFRS adoption was intended to enhance comparability and transparency, studies suggest that its effectiveness depends largely on firm-level governance mechanisms and regulatory enforcement capacity (Madawaki, 2012; Okpala, 2012). In practice, compliance with accounting standards may be

largely symbolic if monitoring and enforcement mechanisms are weak, thereby limiting improvements in reporting quality.

The consumer goods sector in Nigeria presents unique financial reporting challenges due to intense market competition, volatile macroeconomic conditions, and pressure to meet investor expectations. Rising production costs, exchange rate instability, and fluctuating consumer demand may incentivize managers to smooth earnings or engage in opportunistic reporting to present stable financial performance. Consequently, the quality of financial reporting in this sector has significant implications for investor confidence, credit decisions, and regulatory oversight.

Improving financial reporting quality is therefore a critical governance objective for Nigerian firms. High-quality reporting enhances transparency, reduces the cost of capital, and strengthens the credibility of financial markets (Francis et al., 2005). It also supports regulatory effectiveness by enabling timely detection of financial distress and non-compliance. Achieving sustainable improvements in financial reporting quality requires not only robust accounting standards but also effective corporate governance mechanisms, particularly strong board oversight and independence.

In this regard, financial reporting quality should be viewed as an outcome of the interaction between accounting rules, governance structures, and institutional environments. In emerging economies like Nigeria, strengthening internal governance mechanisms remains essential for ensuring that financial reports fulfill their intended role as reliable and decision-useful instruments for stakeholders.

Theoretical Perspective

The relationship between board independence and financial reporting quality is firmly anchored in several theoretical frameworks within corporate governance literature, most notably **agency theory**, **stakeholder theory**, and **resource dependence theory**. These perspectives collectively explain how independent boards influence managerial behavior, enhance oversight, and improve the credibility of financial reporting, particularly in environments characterized by weak institutional enforcement.

Agency Theory Perspective

Agency theory provides the foundational explanation for the role of board independence in corporate governance. According to Jensen and Meckling (1976), the separation of ownership and control in modern corporations creates agency conflicts, as managers (agents) may pursue personal objectives that diverge from the interests of shareholders (principals). These conflicts are often intensified when information asymmetry exists, allowing managers to engage in opportunistic behaviors such as earnings management and selective financial disclosure.

Independent directors function as critical monitoring agents within the agency framework. Their independence from management reduces the likelihood of collusion and increases their capacity to challenge executive decisions objectively (Fama & Jensen, 1983). By overseeing the financial reporting process, independent directors help ensure that financial statements faithfully reflect economic reality rather than managerial preferences. Their presence strengthens internal controls, enhances audit committee effectiveness, and reduces the scope for manipulation of accounting numbers (Beasley, 1996; Klein, 2002).

Furthermore, agency theory suggests that effective monitoring reduces agency costs by aligning managerial actions with shareholder interests. High-quality financial reporting serves as a key outcome of this alignment, as transparent and reliable disclosures limit managerial discretion and improve market discipline (Bushman & Smith, 2001). In this sense, board independence acts as a governance mechanism that constrains opportunistic reporting behavior and promotes accountability.

Stakeholder Theory Perspective

While agency theory focuses primarily on shareholder–manager relationships, **stakeholder theory** broadens the scope of corporate accountability to include a wider set of interests. Freeman (1984) argues that firms have obligations not only to shareholders but also to other stakeholders such as employees, creditors, customers, regulators, and the broader society. From this perspective, financial reporting quality is essential for maintaining trust and legitimacy among diverse stakeholder groups.

Independent boards are particularly important within the stakeholder framework because they are less likely to prioritize narrow managerial or controlling shareholder interests. Instead, independent directors are expected to promote balanced decision-making and ethical conduct, ensuring that financial reports are transparent, accurate, and accessible to all stakeholders (Donaldson & Preston, 1995). Transparent financial reporting enhances stakeholder confidence, supports regulatory compliance, and reinforces corporate legitimacy, which are essential for long-term organizational sustainability.

In emerging markets like Nigeria, where stakeholder protection mechanisms may be weak, independent boards play a crucial role in compensating for institutional deficiencies. High-quality financial reporting becomes a means of demonstrating accountability and building credibility with external stakeholders, including international investors and development partners.

Resource Dependence Theory Perspective

In addition to agency and stakeholder theories, **resource dependence theory** provides further insight into the relationship between board independence and financial reporting quality. Pfeffer and Salancik (1978) argue that boards serve as providers of critical resources, including expertise, legitimacy, and access to external networks. Independent directors often possess diverse professional backgrounds, industry experience, and financial expertise that enhance board deliberations and oversight functions.

From a financial reporting perspective, independent directors with accounting, auditing, or financial expertise can improve the quality of oversight over complex reporting issues and enhance interactions with external auditors. Their reputational concerns also motivate them to uphold high reporting standards, as association with financial misstatements could damage their professional standing (Fama, 1980). Consequently, resource-rich independent boards are better positioned to demand rigorous reporting practices and resist managerial pressures to manipulate earnings.

Institutional Context and Emerging Markets

The relevance of these theoretical perspectives is particularly pronounced in emerging market contexts such as Nigeria. Weak regulatory enforcement, concentrated ownership structures, and social ties between board members and management may undermine governance effectiveness (La Porta et al., 1998; Adegbite, 2015). In such environments, the presence of genuinely independent directors becomes critical for strengthening oversight and enhancing financial reporting quality.

However, theory also suggests that the effectiveness of board independence depends on contextual factors, including legal frameworks, enforcement mechanisms, and cultural norms. Institutional theory highlights that formal governance structures may not always translate into substantive outcomes if compliance is symbolic rather than genuine (DiMaggio & Powell, 1983). As such, the impact of board independence on financial reporting quality in Nigeria must be understood within the broader institutional environment.

Theoretical Implications for Financial Reporting Quality

Collectively, these theoretical perspectives underscore the central role of board independence in promoting high-quality financial reporting. Agency theory emphasizes monitoring and control, stakeholder theory highlights accountability and legitimacy, while resource

dependence theory focuses on expertise and access to critical resources. Together, they provide a robust theoretical foundation for understanding how independent boards can enhance transparency, reduce opportunistic reporting, and improve the credibility of financial statements.

In the context of Nigerian consumer goods firms, these theories suggest that board independence is not merely a formal requirement but a substantive governance mechanism capable of improving financial reporting quality. Strengthening board independence can therefore contribute to improved corporate accountability, enhanced stakeholder trust, and more efficient capital markets in emerging economies.

Implications for Corporate Governance

Strengthening board independence has far-reaching implications for the effectiveness of corporate governance in Nigeria, particularly in relation to financial reporting quality and market confidence. While regulatory frameworks in Nigeria increasingly emphasize board independence, the challenge lies not only in prescribing minimum requirements but also in ensuring substantive compliance. Regulators should therefore move beyond a checklist approach and focus on enforcing genuine independence in board appointments, tenure, and conduct. This includes stricter scrutiny of director relationships, limits on prolonged board tenure, and enhanced disclosure of director affiliations that may impair objectivity (Financial Reporting Council of Nigeria, 2018; Adebite, 2015).

From a policy perspective, regulatory bodies such as the Securities and Exchange Commission and the Financial Reporting Council should strengthen monitoring and enforcement mechanisms to ensure that independence requirements translate into effective oversight. Periodic governance audits, sanctions for non-compliance, and public disclosure of governance violations could enhance accountability and deter symbolic adherence to governance codes. Prior studies suggest that governance reforms are more effective when supported by credible enforcement and investor protection mechanisms (La Porta et al., 1998).

At the firm level, particularly within the consumer goods sector, board independence should be viewed as a strategic governance investment rather than a regulatory obligation. Firms should prioritize the appointment of independent directors with relevant financial, accounting, and industry expertise, as such competencies enhance the board's ability to oversee financial reporting processes effectively (Klein, 2002). Ethical standing and professional reputation should also be central considerations, as directors with strong reputational incentives are more likely to demand high standards of transparency and resist managerial pressure to manipulate financial outcomes (Fama, 1980).

In addition, firms should empower independent directors through well-structured board committees, particularly audit and risk committees. Audit committees dominated by independent directors have been shown to improve oversight of financial reporting, strengthen internal controls, and enhance the quality of engagement with external auditors (Beasley et al., 2009). Providing independent directors with access to timely information, external professional advice, and continuous training further enhances their effectiveness and contributes to higher financial reporting quality.

For investors, board independence serves as a critical indicator of governance quality and financial reporting credibility. In markets characterized by information asymmetry, investors rely heavily on governance signals when evaluating firm performance and risk. Firms with genuinely independent boards are perceived as less prone to earnings manipulation and financial misstatements, which can increase investor confidence and attract long-term capital (Bushman & Smith, 2001). Enhanced transparency resulting from independent oversight may also reduce perceived risk, thereby lowering the cost of equity and debt financing (Francis et al., 2005).

Institutional investors, in particular, can play a proactive role by incorporating board independence criteria into their investment screening and engagement strategies. Active ownership and shareholder activism can complement regulatory efforts by encouraging firms to strengthen board independence and improve disclosure practices. Such market-based governance mechanisms are especially important in emerging economies, where formal enforcement may be limited (Claessens & Yurtoglu, 2013).

At the broader market level, improved board independence contributes to the development of a more transparent and credible corporate sector. High-quality financial reporting supported by independent boards enhances capital market efficiency, facilitates cross-border investment, and supports economic growth. In Nigeria's consumer goods sector, where firms are highly visible and influential, stronger governance practices can set benchmarks for other industries and promote wider adoption of best practices.

Ultimately, strengthening board independence requires a coordinated approach involving regulators, firms, investors, and professional bodies. Regulatory reforms must be complemented by firm-level commitment to ethical governance and investor vigilance. When effectively implemented, board independence can serve as a powerful mechanism for improving financial reporting quality, enhancing corporate accountability, and fostering sustainable development in Nigeria's corporate sector.

CONCLUSION

Board independence remains a vital determinant of financial reporting quality in Nigerian consumer goods firms, particularly within an institutional environment characterized by weak enforcement mechanisms and complex ownership structures. This article has highlighted that independent directors play a critical role in enhancing board oversight, constraining managerial opportunism, and promoting transparent and credible financial disclosures. By exercising objective judgment and monitoring management actions, independent boards help ensure that financial statements faithfully represent firms' economic realities rather than serving short-term managerial interests.

Drawing from agency theory, stakeholder theory, and resource dependence theory, the discussion underscores that board independence functions as more than a formal governance requirement; it is a substantive mechanism for improving accountability and reporting integrity. Independent directors mitigate agency conflicts by reducing information asymmetry and strengthening internal controls, while also promoting broader stakeholder confidence through transparent reporting practices (Jensen & Meckling, 1976; Freeman, 1984; Bushman & Smith, 2001). These theoretical insights are particularly relevant in emerging markets like Nigeria, where governance structures often substitute for weak external monitoring systems.

In the Nigerian consumer goods sector, the importance of board independence is amplified by intense market competition, high public visibility, and increasing scrutiny from regulators and investors. Firms operating in this sector face significant pressures to meet earnings expectations, which may increase the risk of earnings management and financial misstatements. Independent directors serve as a crucial counterbalance to these pressures by strengthening audit oversight, enhancing engagement with external auditors, and supporting compliance with accounting standards (Klein, 2002; Beasley et al., 2009). As such, board independence contributes not only to improved financial reporting quality but also to stronger corporate reputation and long-term sustainability.

The article further emphasizes that improvements in financial reporting quality depend on the substance rather than the form of board independence. While Nigerian governance codes mandate the inclusion of independent directors, their effectiveness ultimately hinges on genuine independence, professional competence, and ethical commitment. Symbolic compliance, driven by relational ties or prolonged board tenure, risks undermining the intended benefits of governance reforms (Adegbite, 2015). Consequently, regulatory

authorities must complement formal requirements with robust enforcement, transparency in board appointment processes, and ongoing evaluation of director independence.

From a policy and practice perspective, the findings underscore the need for continued regulatory vigilance and firm-level commitment to effective board structures. Regulators should strengthen monitoring and enforcement mechanisms to ensure that governance codes translate into meaningful improvements in reporting quality. Firms, in turn, must view board independence as a strategic asset rather than a compliance obligation, investing in directors with relevant financial expertise and strong reputational incentives. For investors, board independence remains a valuable signal of governance quality and financial reporting credibility, influencing investment decisions and capital allocation (Francis et al., 2005).

In conclusion, strengthening board independence represents a critical pathway toward improving financial reporting quality, enhancing investor confidence, and promoting capital market development in Nigeria. As corporate governance reforms continue to evolve, sustained emphasis on genuine board independence will be essential for achieving transparent, accountable, and sustainable corporate practices in Nigeria's consumer goods sector and other emerging market contexts.

Recommendations

1. For Regulators:

- a. Intensify monitoring and enforcement of corporate governance provisions, particularly the independence of boards.
- b. Establish minimum standards for audit firms to enhance quality across the industry.

2. For Companies:

- a. Ensure that a significant proportion of board members are independent directors with relevant expertise to provide objective oversight.
- b. Engage reputable audit firms and maintain transparency in auditor selection and remuneration to avoid compromise.

3. For Policy Makers:

- a. Introduce incentives for firms that demonstrate high governance standards, such as tax benefits or preferential access to government contracts.
- b. Support continuous training for board members and auditors to enhance their capacity to oversee complex financial activities.

4. For Investors and Stakeholders:

- a. Demand greater accountability from firms by paying attention to board composition and the quality of external auditors when making investment decisions.
- b. Encourage shareholder activism to strengthen governance practices in listed firms.

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