# Real Earnings Management and Future Financial Performance of Quoted Consumer Goods Companies in Nigeria

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Reporting earnings to managers and shareholders differently aggravates information asymmetry and distorts stakeholders' estimates of a firm's value. This study examines the effect of real earnings management (REM) on future financial performance in quoted consumer goods companies in Nigeria from 2001 to 2016. Ex-post Facto research design was adopted with an extensive reliance on secondary data obtained from the audited financial statements of the 22 quoted companies. Sales manipulation (earnings management), ROE and EPS (financial performance) and control variables (firm size, growth and financial strength) were analysed using panel Generalized Method of Moments. The study found that quoted consumer goods companies in Nigeria manipulate their earnings through sales. Though insignificant, (P-value=0.810 and 0.459, the subsequent effect of this manipulation on financial performance proxies is positive. Growth had a positive significant effect (Coeff = 0.583 and 0.155, P-value= 0.000 and 0.000) while firm size and financial strength are insignificant (p-value =0.140 and 0.134 respectively). The study concludes that subsequent increase in future financial performance as a result of increase in investment (present earnings manipulation will continuously hide the true picture of financial statement published by such companies. It was therefore recommended that Setters of Accounting Standards should limit opportunistic management discretion in treating financial statement transactions, minimise flexibility of standards, while stiffer penalty should be given to companies caught engaging in such act.

*Keywords:* Earnings Management, Real Earning Management, Accrual Earnings, Return on Equity, Earnings Per Share

## INTRODUCTION

Earnings are determinants of a firm's economic performance and it also provides important information for potential decision about investment. It is of great importance to stakeholders due to its informative and stewardship role. The informative role arises from investors demand for information to predict future cash flows and to assess their risk while the stewardship role of accounting comes from the separation between ownership and management in public firms which puts the manager in a position of a steward to shareholders.

Earnings serve as the indicator of firm's financial strength and health which in turn measures the wealth of stockholders. Managers therefore tend to manipulate these earnings in other to show a good picture of the organization. Bernard and Thomas (1990) and Chaney and Lewis (1995) found that reported accounting earnings and stock prices are closely linked. Thus, the higher the reported accounting earnings are, the higher stock prices because different corporations and prospective investors are attracted towards such companies for investment purposes and hence, subsequent stock prices rise.

Managers can also influence the value of its stock market through earnings management through



income smoothing and earnings growth over time. They have the flexibility to choose among several alternative ways of recording transactions as well as selecting the options that exist within the same accounting treatment. This flexibility which is intended to allow managers to adapt to a variety of economic situations and describe the real economic consequences of the transaction can also be used to influence the level of income at a certain time in order to provide benefits to management and stakeholders. Managers therefore employ various techniques and strategies which are legal and sometimes illegal to achieve specific earning goals.

Earnings management (EM) according to Whittington, and Delany (2013) is a fraudulent practice by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantages. It is by no means a risk-free venture as there are vast majority of adverse effects including drop in share price, regulatory investigation, high cost of capital, and low market share following earnings management announcement (Sadiq, 2015). He was of the opinion that public disclosure of earnings manipulation is followed by court cases from aggrieved shareholders and other concerned stakeholders as well as loss in investors' confidence and decline in share prices of affected companies.

Ali and Zhang (2012) provided evidence that chief executive officer manipulated earnings in the early period of his tenure in order to capture market and build his repute. More so, capital markets rate of firms is higher when it attains its forecasted target as compared to the firms which failed to meet analyst's forecasts (DeAngelo, DeAngelo & Skinner, 1996)

Sales manipulation was defined by Royhowdhury (2003) as managers trying to boost sales during the year with the sole objective of increasing earnings to meet certain targets. Offering limited time price discount, offering lenient terms of credit, posting sales before they are made and posting sales prior to payment are means by which sales are manipulated.

Corporate failures worldwide (Enron and WorldCom) that led to disintegration of Arthur Anderson, an international accounting firm have brought about doubts in the minds of stakeholders on the credibility and reliability of financial reports. It also calls for investigation into the quality of financial reports and increased clamor for a better governance mechanism worldwide. Contrarily, earnings management has received considerable attention by regulators, market participants and researchers alike due to the need to make excessive profits.

In Nigeria, cases of Cadbury Plc.; Afribank Plc. and Lever brothers (Nig) Plc as pointed out by (Ajayi, 2006) has remained a reference point for fraudulent financial reporting. Series of these failures have undermined the credibility of audited financial reports and have cast doubt in the minds of shareholders as to the true economic and financial position of firms.

Fraudulent financial reporting has dire consequences for the economy of any country and the organizations therein. These effects include financial loss (that runs into billions of dollars annually and dent on the reputation of the organization (Okaro, Okafor, & Ofoegbu, 2014). In the worst scenario, due to the characteristics of concealment of REM, Zang, (2012) demonstrate that it is unlikely to be detected by auditors and regulators.

Uncontrolled business failure in Nigeria and the need to remain profitable had made earnings management to become a critical issue in the country. Thus, determining the extent of earnings management on future performance of companies that are heavily exposed to such incidence is therefore important for restructuring policy guidelines for Nigerian companies.

Sequel to this background, relevant hypotheses were raised to address questions relating to what effect sales manipulation has on Return on Equity (ROE) and on Earnings per Share (EPS) of quoted



consumer goods companies in Nigeria?. Providing answers to this question translate to the objective of this study.

The relationship between earnings management and financial performance using different approaches, variables and varied sectors could be found in Gill, Biger, Mand and Mathur (2013), Tabbassum, Kaleem and Nazir (2014) and Rani, Hussain, and Chand (2013). While Gill et al. used discretionary accruals Tabbassum et al. used sales manipulation and over production as proxies for earnings management. More so, Atu, Atu, Enegbe & Atu, (2016), Egbunike, Ezelibe, & Aroh, (2015) concentrated on the banking industry but Hassan & Ahmed (2012) works on manufacturing sector. Most of these works used accrual based earnings management neglecting the real earnings management aspect. This is a serious omission which forms the focus of this study.

The highest level of fraud (theft of physical assets, corruption and bribery procurement fraud and IP theft) experienced in the manufacturing sector as revealed by 2017/18 Kroll Annual Global Fraud & Risk Report made the sector an important one for consideration. The sector is also characterised with weak legal and financial reporting frameworks and political interference. Emphasis in this study is on the consumer goods companies which forms the largest output producing companies in the country. This is in addition to industry-wise analyses which disclose that earnings management is dominant within the consumer goods (41.93%) in Nigeria.

In this regard, consumer goods companies (being large firms and most valuable companies based on market values) listed in the Nigerian Stock Exchange (NSE) were examined for a period of 16years. These firms due to their large size tend to have higher motivation and prospects to engage in manipulating/ exaggerating earnings (Egbunike, et al. 2015).

### LITERATURE REVIEW Conceptual Framework

Earnings management (EM) according to Healy and Wahlen (1999) occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers. It is the choice of a manager of accounting policies or other actions including voluntary earnings forecasting, voluntary disclosure, and estimation of accrual to affect earnings intentionally (Chi-Keung Hang & Brossa, 2013).

Based on core attention for the finance and accounting researchers, EM was classified by Schipper (1989), Healy and Wahlen (1999) into accruals earnings management (AEM) and real earnings management (REM). While AEM involves within-GAAP choices that try to "obscure" or "mask" true economic performance, REM on the other hand occurs when managers undertake actions that deviate from the first best practice to increase reported earnings (Gunny, 2005)

AEM means to manipulate the earnings through the utilization of accounting principles provided by GAAP, whereas REM means to accelerate earnings by changing some business activities. Examples of AEM are provisions for bad debt expenses and timing asset write-offs, whereas examples of REM are manipulation of R&D expenses, overproduction, manipulation in advertising expenses and sales manipulation

The study of Hashemi and Rabiee (2011) revealed that AEM occurs after REM and firms that engaged in AEM are found more likely to be sued as compared to those engaged in REM. Thus, mangers prefer REM as compared to AEM (Mohammed, 2018) because REM involves less cost to conduct and cannot be detected easily by investors.



Eldenburg, Eldenburg, Hee & Soderstrom (2011) et al. (2007) provided evidence that non-profit organizations like hospitals engaged in REM activities for smooth earnings. Even though AEM may be less costly with respect to future firm value, Graham, Harvey, and Rajgopal (2005) found that most respondents would prefer to use real variables to manage earnings. This is because aggressive accounting choices with respect to accruals are at higher risk for Security and Exchange Commission (SEC) scrutiny and class litigation. Secondly, the firm may have limited ability to report discretionary accruals; for example, accruals management is limited by the business operations and by accrual manipulation in prior years (Barton & Simko, 2002).

In addition, accruals management must take place at the end of the year and managers face uncertainty as to which accounting treatments the auditor will allow at that time. Operating decisions are controlled by the manager, whereas accounting treatments must meet the requirements of auditors. Cohen and Zarowin (2010) found that REM has several negative effects on future performance than AEM. However, Leggett, Parsons and Reitenga (2010) found that firms engaged in REM to avoid reporting less income have lower operating cash flow and ROA in the coming years as compared to the firm reporting loss and without REM practices.

REM can be difficult to measure and it has been measured differently in the literature (Gunny, 2005) and (Roychowdhury (2006). However, the studies of Taylor and Xu (2010) and Tabbassum et al. (2014) proxy REM with sales manipulation, over production, reduction in discretionary expenses and timing of sales of fixed assets.

Firm financial performances are evaluated through financial statement analysis that uses traditional accounting measures based on relationships among financial statement items.

While Klein (1998) and Lo (2003) employ return on assets (ROA) and return on equity (ROE) as indicators of firm performance, Brown and Caylor

(2004) employ both measures. A combination of these variables in addition to EBIT, EPS, P/E and net profit margin have been adopted by other scholars (Umobong & Ibanichuka , 2016)

Overall, both ROA and ROE are useful overall performance indicators but ROE being an internal measure of performance is by far the most popular measure of performance upon public information (Tabbassum et al. 2014). ROE is also proposed to be a direct assessment of the financial return of shareholder's investment and it's easily available for analysts who rely on such statements.

#### Theoretical Background

The agency theory, stewardship theory, stakeholder's theory and income smoothening hypothesis were considered relevant to this study.

The stakeholder theory, developed by Freeman (1984) advocates that managers in organizations have a network of relationships to serve; this include employees, shareholders, suppliers, business partners and contractors. This theory is at variance with agency theory which advocates the existence of contractual relationship between managers and shareholders; whereby managers have the sole objective of maximizing shareholder's wealth.

Stakeholder theory considers this view to be too narrow, as manager actions impact other interested parties, other than shareholders. In essence, the stakeholder theory emphasizes the need for managers to be accountable to stakeholders. To ensure adequate protection of stakeholders' interest therefore, stakeholder theory proposes the representation of various interest groups on the organization's board to ensure consensus building, avoid conflicts, and harmonize efforts to achieve organizational objectives. (Donaldson & Preston 1995).

Stakeholder's theory has been criticized for over saddling managers with responsibility of being accountable to several stakeholders without specific



guidelines for solving problems associated with conflict of interests. However, Freeman (1984) contends that the network of relationships with many groups can impact decision making processes. As such, stakeholder theory is concerned with the nature of these relationships in terms of processes and outcomes for the firm and its stakeholders. Likewise, Donaldson and Preston (1995) assert that stakeholder's theory which focuses on managerial decision making and interests of all stakeholders have intrinsic value, and no sets of interests is assumed to dominate the other. This suggests that managers are expected to consider the interests and influences of people who are either affected or may be affected by a firm's policies and operations (Frederick et al. (1992). Similarly, Jensen (2001) affirms that managers should pursue objectives that would promote the long-term value of the firm by protecting the interest of all stakeholders.

The intention of managers in carrying out REM determines the class of stakeholders that bear the loss. In some cases, managers manipulate earnings for their own personal gains at the expense of shareholders and other stakeholders in other cases. Thus, they manipulate earnings with the consent of shareholders but at the expense of other stakeholders. Hence, shareholders could be at the losing end while in some cases other stakeholders could be affected by the activities of the managers in future.

Income smoothing hypothesis was first suggested by Hepworth (1953) and further elaborated by Gordon (1966). It connotes the use of accounting methods to average income from one period to another. Firms embark on this practice out of the belief that investors/capital providers will be willing to pay something extra on the market value of stock when the income of a firm is steady from period to period as against firms with fluctuations in income. It does not necessarily involve violation of accounting rules but rather managers leveraging on latitude provided by accounting rules to manage accounting numbers. Examples include bogus provisioning for bad debts even when the loans are not likely to go bad, over statement of expenses and understatement of receivables. The motivation is normally either to satisfy external users of accounting information; creditors and investors or internal users of information or management which may be for compensation benefits or threat of management displacement. The underlying assumption when viewed from the perspective of satisfying management is that without smoothing, there will be dispersion in earnings over the years. The higher the variability in earnings, the higher the risk that investors and creditors will have negative outlook of the firm. This will in turn affect investor's capitalization rate with negative effect on the share prices of the firm.

### **EMPIRICAL EVIDENCES**

The importance and pervasiveness of EM have attracted attention to it since 1980s. For instance, the works of Akram, Hunjra, Butt and Ijaz. (2015), Tabbassum et al. (2014), Leggett et al. (2010) and Umobong and Ibanichuka (2016) are landmark achievements in this field. While Tabbassum et al. (2014) reported that 30% - 50% of firms in Pakistan engaged in earnings manipulation which in turn have adverse impact on the performance of the firms, Leggett et al. (2010) revealed that manipulation through discretionary expenses caused lower operating performance in future. Similar negative impacts of REM on corporate performance was reported by Francis, Iftekhar & Li. (2011), Li (2010) and Chen & Liu (2010).

Gunny (2005) illustrates the consequences of REM to be economically significant on subsequent operating performance. Specifically, all four types of REM activities were associated with lower ROA compared to non-REM firms after controlling for size, performance, accruals, and industry. In addition, the persistence of ROA is significantly lower for Asset and Production RM firm-years. The analysis suggests that, overall, identifying all four types of RM is incrementally informative about future earnings and cash flows.



Similarly, Taylor and Xu (2010) found that firms identified as conducting REM activities do not experience a significant decline in subsequent operating performance. The finding enhances their understanding of the process through which management evaluates the costs and benefits of REM and helps address concerns about costs of the increase in REM activities that arose due to the heightened accounting regulation implemented by the Sarbanes-Oxley Act.

Conversely, the comparative study in Pakistan and India by Akram et al. (2015) reveals a significant negative relationship (in Pakistan) but insignificant relation in India between earnings management and organizational performance.

In Nigeria, the study of Umobong and Ibanichuka (2016) indicates that TAT have significant relationships with ROA, ROE and EPS implying it could be used for accounting manipulations. A decrease in TAT increases ROE and vice versa was also confirmed in the study.

Gill et al. (2013) found that the more intense the practice of earnings management, the greater it's adverse effect on corporate rate of return on assets in the following year. The study also found that to some extent, the market realizes that management acts with selfish motives and responds by lowering share prices and corporate market value.

A study of the Jordanian manufacturing companies by Nabil et al. (2014) reveals no impact on financial performance indicators (EPS and CR) by the process of EM but ROE has an impact on the process of EM in companies listed at Amman Stock Exchange.

The summary of review noted a significant concentration on accrual based EM (Hassan and Ahmed, 2012), Gill et al (2010) and Akram et al (2015) while the service sector or a combination of all companies was the sector emphasis. Specifically, in Nigeria, only Umobong and Ibanichuka (2016) used REM through timing of assets transactions in manufacturing sector. To this end, sales manipulation aspect of REM had not received adequate attention and as such left a wide gap in the literature.

### METHODOLOGY

### Model Specification

The relationship between REM and future financial performance is amenable to the model used by Tabbassum et al. (2014) which was stated as:

$ROE_{it+1} = \alpha_0 + \alpha_1 REM_{it} + \alpha_2 LOGASSETS_{it+1} + \alpha_3 ZSCORE$	t+1
$+\alpha_4 \text{ID}+\alpha_5 \text{BTM}_{t+1}+\alpha_6 \text{ROE}_1+\text{E}_{it}$	(i)

Where: ROE = Return on Equity, REM = Real earnings management, LOGASSETS = Firm size, ZSCORE = Financial Strength, ID = Industry dummy, BTM = Growth.

Control for industry effects (ID) was expunded because this study considers consumer goods companies within the same industry. Hence the model was modified as follows:

$ROE_{it+1} = \alpha_0 + \alpha_1 REM_{it} + \alpha_2 LOGASSETS_{it+1} + \alpha_3 ZSCOR$	E <sub>t+1</sub>
$+\alpha_4 BTM_{t+1} + \alpha_5 ROE_t + E_{it}$	(ii)

Where: ROE = Return on Equity, REM = Real earnings management, LOGASSETS = Firm size, ZSCORE = Financial Strength, BTM = Growth

REM (proxy by sales manipulation), Return on Equity (ROE) and Earnings Per Share (EPS)-(variables with embedded earnings content) were used as proxies for financial performance. However, firm size was used as control variable and is measured as natural logarithm of total assets (LOGASSETS).

Managers accelerate sales by offering sales discount or more lenient credit terms (Roychowdhury, 2003). By doing this, total earnings increase but profit margin and cash flows decrease compared to sales.



Thus, sales manipulation leads to abnormal lower cash flows. To investigate firms engaged in sales manipulation, it is important to measure abnormal level of operating cash flows. On the contrary, to measure normal level of cash flows (CFOs), the model in (iv) as proposed by Dechow, Kothari & Watts (1998) and later used by Li (2010) was adopted.

Where: CFO = Operating Cash Flows,  $S_t$  = Sales during time t,  $A_t$  = Total assets at time t.

By applying this model to the data of selected companies, residuals are taken as level of abnormal operating cash flows. The lower the value of the residual, the higher the value of abnormal lower operating cash flows. For the sake of convenience and uniformity, residuals are multiplied by -1 and denoted REM (which is the measure of abnormal lower operating cash flows). The higher the value of this variable, the higher will be the value of REM through sales manipulation.

In addition, firm growth is considered as an important determinant of firm performance (Santo & Britto (2012). Growth in this study is proxy by BTM

which = 
$$\frac{\text{Market value of equity}}{\text{Book value of equity}}$$
 .....(v)

Application of the usage of such relationship can be found in Roychowdhury (2006) and Tabbassum et al. (2014)

Financial performance has also been reported to be highly correlated with firm size, growth and financial strength (Gunny, 2010). As such, slight modifications to Altman (1968) ZSCORE formula and that of Tabbassum et al (2014) led to (eq. vi) as follows:

Ex-post Facto Research design was used in which the population and sample comprise all the 22 consumer goods companies listed on the Nigerian Stock Exchange. Secondary data were obtained from annual reports of these companies and were analysed using Panel Generalized Method of Moments (GMM) as it addresses both heterogeneity and serial correlation problem in a dynamic panel data model.

### ANALYSIS AND RESULTS Unit Root Test

The Fisher-type unit root test was carried out and as presented in Table 1 reports four test statistics namely inverse chi-squared P, inverse normal z, inverse logit L\* and modified inverse chi-squared Pm. The table shows that all the four test statistics reject the null of the series having unit roots for real earnings management, financial strength, firm size and growth. The only exception is in the cases of ROE and EPS where all test statistics reject the null hypothesis at first difference for the two variables. These results indicate that the variables used in the model are at least stationary at first difference.

#### Regression Analysis

The Panel One-Step System Generalized Method of Moments (GMM) regression results is presented in Table 2. Column 2 and 4 in the Table present the results of the effect of REM on future financial performance of quoted consumer goods firms in Nigeria using ROE and EPS respectively.

In each of the models, effect of REM in previous period is examined on ROE and EPS respectively controlling for financial strength (ZSCORE), firm size (LOGASSETS) and growth (BTM). This procedure implies the inclusion of lagged ROE and EPS in their respective models.



Table 1: Fisher-type Unit Root Test						
	(1)	(2)	(3)	(4)		
VARIABLES	Р	Z	L*	Pm		
ROE	13.7982	-0.4512	-0.4727	0.3671		
EPS	18.3088	-0.9399	-0.9898	1.2878		
REM	48.1159***	-4.1273***	-4.8861***	7.3721***		
Strength	91.2566***	-5.5723***	-9.7781***	16.1782***		
Firm Size	84.8926***	-5.1634***	-8.9456***	14.8791***		
Growth	58.8595***	-5.7278***	-6.6820***	9.5652***		

Source: Authors' Computation, (2019).

Table 2: Effect of Real Earnings Management on Future Financial Performance						
	(ROE MODEL)		(EPS MODEL)			
VARIABLES	Coefficient	p-value	Coefficient	p-value		
ROE(-1) / EPS(-1)	0.777*** (0.084)	0.000	0.804*** (0.052)	0.000		
REM(-1)	0.147 (0.612)	0.810	0.089 (0.120)	0.459		
Strength	728.6 (487.8)	0.135	698.6 (660.9)	0.290		
Firm Size	-132.8 (89.91)	0.140	-127.6 (121.5)	0.293		
Growth	0.583*** (0.136)	0.000	0.155*** (0.027)	0.000		
Constant	-4642.1 (3100.8)	0.134	-4448.7 (4200.7)	0.290		
Observations	79		60			
Wald Chi <sup>2</sup>	871.85***		656627.8***			
p-value	0.0000		0.000			
Sargan Test	27.457		10.701			
p-value	0.4394		0.8716			
AR test (2)	1.1459		0.8739			
p-value	0.2518		0.3822			
Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1						

Source: Authors' Computation, (2019).



The Sargan test of over identifying restrictions conducted for the two models shows chi-squared values of approximately 27.46 and 10.70, and pvalues of 0.439 and 0.872 for ROE and EPS respectively. The underlying null hypothesis is that over identifying restrictions are valid. The results provide no sufficient evidence to reject the null hypothesis in the two models as each of the p-values are greater than 0.05 significance levels. If the null hypothesis is rejected, the model is over-identified and it does not fit into the GMM framework (Roodman, 2009).

Not rejecting the null hypothesis in these models implies that the set of instruments used are valid. The Arellano and Bond test for autocorrelation was applied to the differenced residuals and has a null hypothesis of no autocorrelation. The goodness of fit of the model as measured by the Wald Chi-squared of 0.000 and 0.000 respectively indicate the models fit the data well since their respective null hypothesis of joint insignificance of all independent variables are rejected.

From Table 2, ROE is seen to influence its future value positively and significantly at 1% (p =0.0000). by inference therefore, a 1 percent point increase in ROE in the current period results to an 0.777 increase in ROE in the next period. Thus, ROE of consumer goods firms highly influences its future values. Growth is seen to be highly significant in influencing ROE of consumer goods firms (p= 0.000). coefficient of 0.583 indicates that 1 percent point increase in growth results to an increase in ROE by 0.583 percent. Similar results obtain when performance is measured using EPS but its effect is an increase in EPS by 0.155 %.

Although the coefficients of REM and strength are positive (0.147 &728.6) and that of firm size is negative (-132.8), their respective p values of 0.810, 0.135 and 0.140 indicate their statistical insignificance.

The same goes for EPS which was significantly

positive at 1% (p=0.0000) such that 1 percent increase in EPS in the current period results to an increase of 0.840% in EPS in the next period (coeff =0.840). Thus, given an increase in EPS in the past period, the future EPS of consumer goods firms are likely to increase in the future.

REM is seen to be statistically insignificant in influencing EPS of consumer goods firms. Financial strength and firm size are also not statistically significant. Since the p-values being 0.459, 0.290, and 0.293 are greater than 0.05. Going by the result of these two models, it was found that REM does not have significant impact on future financial performance of consumer goods firms in Nigeria.

# **DISCUSSION OF FINDINGS**

The study revealed that REM has a positive and insignificant effect on financial performance on the selected consumer goods companies in Nigeria. Thus, an increase in REM gave rise to an increase in both financial performance proxies (ROE and EPS) by 14.7% and 8.9% respectively. Consistent with this result, Chen & Liu (2010) reported a positive relationship between REM and operating performance. Taylor and Xu (2010) also reported that REM does not have a significant decline in subsequent performance. Furthermore, Umobong and Ibanichuka (2016) using Timing of Assets Transactions (TAT) as a proxy for REM, reported that TAT has a positive relationship with EPS but a negative relationship with ROE.

The aggregate result disagrees with that of Tabbassum et al. (2014); Leggett et al. (2010); Gunny (2010); Akram et al. (2015) who reported a significant negative relationship between REM and future performance.

Furthermore, the effect of the three control variables (firm size, growth and financial strength) produced a contradictory outcome. For instance, growth has a positive and significant effect on future performance such that an increase in growth leads to an increase



in future EPS and ROE.

Contrastingly, firm size and financial strength are reported to be insignificant at influencing both ROE and EPS. This agrees with Tabbassum et al. (2014) and Gill et al. (2013) but contradicts that of Roychowdhury (2006).

These results go in line with income smoothening hypothesis such that he higher the variability in earnings the higher the risk that investors and creditors will have negative outlook of the firm.

### **CONCLUSION AND RECOMMENDATIONS**

The study examined the effect of REM using two financial performance proxies (ROE and EPS) and sales manipulation as a proxy for earnings. It was found that quoted consumer goods companies manipulate their earnings through sales. This was shown by decrease in cash flow from operating activities with reported increase in revenue.

It was also found that REM has a positive effect on financial performance though insignificant. Thus, as REM increases, financial performance proxies (ROE and EPS) increases. The activities engaged by these companies by manipulating sales to increase or boost present performance led to further increase in future financial performance. The study asserts that companies who engage in REM to boost present financial performance also witness positive but insignificant increase in future financial performance.

The subsequent increase in future performance could be as a result of increase in investment due to present earnings manipulation which leads to subsequent and future increase in financial performance. When companies manipulate their earnings and have a positive response, this attract investors and also increase the borrowing power of such companies thereby increasing subsequent performance as a result, no adverse effect is reported in future performance The increase in financial performance even with presence of earnings management could be as a result of subsequent manipulation of earnings by such companies which would continuously hide the true picture of financial statement published by such companies.

#### Recommendations

Based on the conclusions reached and to aid strategic policy formulation by consumer good companies it was recommended that:

- i. IFRS setters should be enjoined to lower flexibility in standards that are open to more practices of earnings management. Thus, standards should be specific and clear.
- ii. Management's accounting-related choices that provide opportunities to manage earnings through timing of transactions and making estimates should be monitored,
- iii. Continuous revision of tax legislations should be embarked upon to curtail earnings management practices
- iv. Adequate penalties should be given to companies caught engaging in unhealthy manipulation of earnings.to to distort fairness of financial statements.

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