UNIVERSITY OF CAPE COAST

EARNINGS MANAGEMENT, INSTITUTIONAL STRUCTURES AND PERFORMANCE OF BANKS IN SUB-SAHARAN AFRICA

COMFORT AMA AKORFA ANIPA

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BY

COMFORT AMA AKORFA ANIPA

Thesis submitted to the School of Business of the College of Humanities and Legal Studies, University of Cape Coast, in partial fulfilment of the requirements for the award of Doctor of Philosophy in Business Administration

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DECLARATION

Candidate's Declaration

I hereby declare that this thesis is the result of my own original research and that no part of it has been presented for another degree in this University or elsewhere.

Candidate's Signature: …… Date: ……

Name: Comfort Ama Arkorfa ANIPA

Supervisors' Declaration

We hereby declare that the preparation and presentation of the thesis were supervised in accordance with the guidelines on supervision of thesis laid down by the University of Cape Coast.

Principal Supervisor's Signature: …… Date: …….

Name: Rev Prof. George Nii Tackie

Co-Supervisor's Signature: …… Date: ……..

Name: Dr. Mohammed Zangina M. Isshaq

ABSTRACT

This thesis investigates how certain institutional structures impact the interplay between earnings management and financial performance in banking institutions across sub-Saharan Africa (SSA). Specifically, it delves into three key areas: 1) The influence of robust auditing and financial reporting standards on banks' earnings management behaviour 2) The interrelationships among contractual enforcement mechanisms, political institutions, and earnings management in SSA banks; and 3) The moderating effects of auditing and reporting standards, as well as contractual institutions on the link between earnings management and bank performance in the region. The data spans from 2007 to 2021, constrained by the availability of relevant data for the primary variables under scrutiny. Analytical techniques employed include the Generalized Method of Moments (GMM) estimator. Findings reveal that stringent auditing and reporting standards tend to curtail earnings management activities among SSA banks. Additionally, well-developed contractual institutions appear to discourage such practices. The deterrent effect of these institutional factors on earnings manipulation is particularly pronounced in countries with robust political institutions. Furthermore, the study uncovers that both rigorous auditing and reporting standards and effective contractual institutions positively moderate the relationship between earnings management and bank performance in SSA economies. This suggests that these institutional frameworks may help channel earnings management practices towards efficiency-enhancing outcomes rather than opportunistic behaviour. Based on these insights, the research recommends that policymakers focus on reinforcing these institutional pillars to promote more transparent and efficient banking practices across sub-Saharan Africa. By doing so, they can potentially harness the constructive aspects of earnings management while mitigating its detrimental effects on bank performance.

KEYWORDS

Bank Performance

Contracting Institutions

Earnings Management

Political Institutions

Strength of Auditing and Reporting Standards

Sub-Saharan Africa

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DEDICATION

To my Family

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LIST OF ACRONYMS

ARS	Auditing and Reporting Standards
DLLP	Discretionary Loan Loss Provision
EM	Earnings Management
PR	Political Rights
PSAV	Political Stability and Absence of Violence
SARS	Strength of Auditing and Reporting Standards
SSA	Sub-Saharan Africa

CHAPTER ONE

INTRODUCTION

The necessity for banks to have proper institutional structures to restrict earnings managements has been an area of academic research recently (Martens, Yapa, Safari & Watts, 2021). The earnings management practices of banks may either exhibit a positive or negative relationship with performance. This study argues that such relationship may depend on the institutional structures in place, such that these institutional structures could ameliorate the adverse effect of earnings management on the performance of banks. Despite improvement in the institutional structures in most sub-Saharan Africa (SSA) countries, banks in SSA face difficulty with the issue of earnings management. Apparently, most research on earnings management has recorded high level of earnings management among banks. This study uncovers specific institutional structures (like contracting institutions and "the strength of auditing and reporting standards") that could be more vital to the connection between bank performance and earnings management. In all, this thesis examines how these institutional structures curtail earnings management practice of banks to enhance performance.

Background to the Study

The reporting practices of banks have become increasingly important to regulators and policy practitioners, owing to the role of poor reporting practices that contributed to the 2007/08, 2012, 2017/18 sluggish performance of banks and the global financial crises. This study examines the motives and the consequences of earnings management practices of banks in sub-Saharan African economies. Earnings management involves using financial reporting

practices to overly present a positive perspective of the activities and financial position of a business. Relative to developed regions like the United States and Europe area, the financial sector of several SSA countries is dominated by banks (Agwu, Amidu & Kuipo, 2015; Amidu & Issahaku, 2019; Ngwu, Ogbechie & Ojah, 2019). Therefore, placing a special focus on SSA to study the earnings management of banks is worthwhile. To avoid sending negative signals sent by non-performing loans to stakeholders, banks in most African economies make recourse to earnings management practices (Mnif & Slimi, 2022). This could cause the loan portfolio of banks to deteriorate and make the banks more vulnerable to external shocks. Thus, managing earnings numbers through a bank's loan loss provision (LLP) may be quite problematic.

Despite the evidence that banks in SSA is shallow in comparison to the global average (Amidu & Issahaku, 2019), SSA banks continue to be at the centre stage on the growth of Africa's banking industry. Due to increased rivalry brought about by the subregion's rise in cross-border banking, banks may turn to a variety of strategies to survive. Amidu and Kuipo (2015), as well as Mnif and Slimi (2022) find evidence of earnings management behaviour among most African banks through the manipulation of LLP. Moreover, in contrast to banks in the US and Europe, African banks are faced with weaker reporting regulations and less developed credit registries, thereby incentivizing these banks to manage their loan loss provisions figures (Ozili, 2017; Beck & Cull, 2013).

One of Africa's priorities is achieving all of the performance-related SDGs. Sub-Sahara Africa, through the reporting standards impact evaluation has put in place several measures to enhance banks' performance and

subsequently communicate the performance in ratios to the stakeholders and the general public. According to the Allen, Metternicht and Wiedmann (2018), UNDP reported that about 80% of the populace in South Asia and sub-Saharan Africa (SSA) live in extreme poverty which means that more work is needed to bring people out of poverty. In so doing, the SDGs' 1 (Elimination of Poverty) can be achieved, thus better performance of bank institution in these regions can enable the creation of work and help in the elimination of poverty. The Financial Intermediation theory explains banks as key intermediaries mobilizing savings, efficiently allocation financial resources and reducing transaction cost (Beck et al., 2021). Also, enhance bank performance can allow income generation opportunities, asset building and emergency funds access. Again, increased bank performance can improve economic empowerment via entrepreneurship support, business expansion financing, working capital provision and skills development funding. Altogether, banking performance can aid reduce poverty.

Earnings management in the banking sector of Africa poses several significant problems for the economic growth in the region (Gerged, Albitar, & Al-Haddad, 2023). When banks engage in earnings management practices, they may appear healthier and more profitable than they actually are. This can attract investment and capital inflows into these banks, diverting resources away from genuinely productive sectors of the economy. As a result, resources are misallocated, hindering the overall economic growth potential. Earnings management practices can distort a bank's true risk profile (Lee & Hwang, 2019). This distortion may lead to difficulty in credit assessments, causing banks to either lend to riskier borrowers or become overly cautious, restricting

access to credit for individuals and businesses. Reduced access to credit can stifle entrepreneurial activity and hinder economic expansion.

Excessive earnings management erodes investor trust in the banking sector. When investors perceive that financial statements are unreliable, they are less likely to invest in banks or the broader economy. Also, diminished investor confidence can deter foreign direct investment and limit access to international capital markets, impeding economic growth (Yakubu et al., 2020). Earnings management can lead to a buildup of systematic/hidden risks within the banking system. Banks that engage in earning management practices may not set aside sufficient reserves for potential losses (Ozili & Outa, 2017). If a financial crisis or economic downturn occurs, these banks may be ill-prepared to weather the storm, potentially triggering a broader systemic crisis that negatively impacts the entire economy.

Reliable financial information is crucial for policymakers and economic planners to make informed decisions. Earnings management can distort economic data, making it difficult for governments to implement effective fiscal and monetary policies (Hussain et al., 2020). This can lead to suboptimal economic outcomes and hinder long-term growth. Trust in the banking industry may decline if the general public learns about earnings management practices. This lack of trust can lead to a decreased willingness to save or invest in financial products, opting for alternative, often informal financial arrangements. Reduced participation in the formal financial sector can limit capital accumulation and economic growth. Addressing earnings management practices often requires robust regulatory and legal frameworks (Saona, Muro & Alvarado, 2020). In SSA, where regulatory capacities may

vary across countries, tackling these issues can be challenging. Regulatory and legal weaknesses can allow earnings management to persist, further undermining economic stability and growth.

The above points show that earnings management in SSA's banking sector poses a multifaceted problem for the region's economic growth. It distorts resource allocation, hampers access to credit, undermines investor confidence, increases systemic risk, distorts economic data, reduces trust in financial institutions, and presents regulatory and legal challenges. Addressing these issues is essential for fostering a healthy and resilient financial sector that may favourably impact the economic growth of the region. The involvement of institutional structures (such as strength of ARS, contracting institutions and political institutions) could play a crucial role in shaping the connection between Sub-Saharan African banks' performance and earnings management. In light of this research, contracting institutions involves institutional structures that ensures contractual obligation between two private parties are successfully performed by each party.

In line with Acemoglu and Johnson (2005), this study looks at contracting institutions in five dimensions, comprising of police reliability, judicial independence, number of contract enforcement procedures, contract enforcement cost and creditor right protection. According to Kamran and Shah (2014), when institutional structures are effective in their roles, they can detect and deter earnings management practices. This promotes transparent financial reporting and ensures that banks adhere to recognized accounting standards, reducing the prevalence of earnings management. Regulatory bodies often implement risk-based guidelines for risk management, stress tests, and capital

adequacy. When these institutions are robust and proactive, they can incentivize banks to focus on genuine risk management rather than resorting to earnings management as a means to artificially improve their financial positions. Effective risk mitigation contributes to the stability and performance of banks.

"Auditing and Reporting Standards", hereafter (ARS) can enhance accountability and transparency within the banking sector (Kurauone, Kong, Sun, Muzamhindo, Famba, & Taghizadeh-Hesary, 2021). Transparency in financial reporting and accountability mechanisms, such as external audits and regulatory oversight, can reduce the scope for earnings management by making it more difficult for banks to manipulate financial statements without detection. Effective ARS may bolster investor confidence in the banking sector. When investors trust that banks are presenting a true and fair view of their annual reports, they are more likely to invest in banks and the broader economy, contributing to the stability of finances and performance of banks. The involvement of contracting institutions as well as SARS in SSA could be essential in reducing procedures related to earnings management and ensuring the overall performance of banks. According to the law and finance theory, common law economies offer a more robust and efficient framework that safeguards those involved in the financial system (La Porta et al., 1998; 2002). These advantages can improve the financial sector's growth and promote openness and confidence. In contrast to civil law economies, common law economies have accounting traditions that promote a high degree of openness, as recently shown by Adela et al. (2022). Consequently, we believe that

common law economies are more likely to benefit from SARS than civil law ones.

Thus, this study's primary goal is to investigate how banks in sub-Saharan Africa handle their earnings in relation to the degree of adherence to auditing and financial reporting standards. The African continent has witnessed an appreciable increase in the process of implementing International Financial Reporting Standards (Tawiah & Boolaky, 2019). At the same time, the continent has committed to auditing standards adoption (Adela et al., 2022). A key research question answered by this study is whether compliance with financial reporting and auditing standards reduces the continent's banks' practices regarding earnings management. This is partly motivated by the role of auditing and reporting standards in enhancing financial reporting quality.

Again, it has been documented that the level of non-performing loans (NPLs) for banks in most African countries is relatively higher as compared to advanced economies owing to weak contract enforcement mechanisms between banks and their borrowers (Andrianova, Baltagi, Demetriades & Fielding, 2015). The most recent evaluation of the stability of Africa's banking sector has been by the IMF in 2014 reported that banks in some countries were making under-provisions for loan losses. Underproviding for bad debts possibly implies poor credit risk management by firms. Subsequently, inadequate provisions incentivize banks to manage earnings figures and weaken transparent disclosures. However, if contract enforcement mechanisms were strong, banks may not incur huge NPLs and may not even need to manage earnings figures. Again, a strong contract enforcement mechanism could lessen the degree to which the bank and other stakeholders

have unequal access to information. (Acemoglu & Johnson, 2005). Another key research question that this study seeks to answer is whether or not contract enforcement mechanisms lessen African banks' earnings management practices.

As earlier explained, evidence of growing inter-country banking in SSA continent implies that the banking sector of the sub-region is becoming more competitive (Ngwu et al., 2019) and may provide incentives for banks to manage earnings. This is because, intuitively, reporting uneconomically realistic low loan loss provision numbers could signal a high level of loan recovery and bank performance, even if it does not reflect the current economic reality and performance of the bank. The growing cross-border banking in Africa has also prompted banking sector regulators to tighten capital adequacy to serve as a buffer when banks are losing out in the competition. To fulfil the regulatory requirements, managers of banks are more likely to hyperbolize the firm's earnings to entice more capital investment. Reporting high earnings figures may also signal high security of deposit, attract more deposits at a lower cost to the bank and eventually enhance bank performance. A natural prediction that emerges from the Positive Accounting theory is that earnings management could influence bank performance.

According to the New Institutional theory, financial reporting procedures, like all other contexts, are shaped by institutional frameworks (Adela et al., 2023). Concerning the institutional context of banks in Africa, Ozili and Outa (2019) highlight those institutional mechanisms that Compared to the US and Europe, the development and enforcement of earnings

management policies are weaker in Africa. Therefore, the earnings management practices of African banks are less developed. The institutional context of Africa thus incentivizes this thesis to empirically Examine whether the connection between bank performance and earnings management is impacted by specific institutional structures. Institutional structures like contracting mechanisms and financial reporting and auditing standards represent key external governance structures that could protect stakeholders from management expropriation (Duong, Kang & Salter, 2022). Strong contract enforcement mechanisms and financial reporting and auditing are anticipated to curtail opportunistic Earning Management (EM) and enhance the credibility gate, regardless of whether the correlation between bank performance and earnings management is impacted by as well as the real economic performance of banks.

Altogether, this research work empirically and theoretically examines the role of the Standards for Auditing and Reporting's (SARS) strength as well as contracting institutions in the connection between earnings management and SSA bank’s performance. Since each of the study's particular goals are outlined in an essay or research article format, the next section motivates the entire study as well as each objective of the study.

Statement of the Problem

This study is partly motivated by the rise in SSA banks' earnings management practices. There has been a tremendous increase in banking sector competition in Africa following the surge in inter-country banking banking activity in the continent (Ngwu et al., 2019). The competition pressure may have led to banks' increased use of earnings management

practice in attempts to sustain themselves. Some researchers have therefore examined the antecedents of banks' earnings management procedures in SSA and have found that globalization, IFRS adoption and audit committees as key factors (Amidu & Issahaku, 2019; Mnif & Slimi, 2022). However, the SARS thereby pointing attention to the compliance of these standards and not mere adoption (Adela et al., 2023), has not been examined. To contribute to this trend, one objective in this thesis examines the relationship between actual compliance to ARS and earnings management of banks in Africa.

In addition, tightened regulations in the banking industry of most African nations may incentivize financial institutions to manage earnings figures. Undercapitalized banks may have incentives to report unrealistic high earnings to attract more capital. Even though recent research in the African context have investigated the connection between performance and earnings management, the focus was not on the banking sector (Boachie & Mensah, 2023). The financial reporting behaviour of banks is essentially distinct from non-financial companies' because of the likely trade-off between transparency and performance. Such a dilemma provides a reason for further investigation between the earnings management of banks and bank performance.

The SSA continent has consistently been at the lower end of institutional quality even though it seems to be improving lately (Abeka et al., 2022). Thus, a gap that this research aims to close is to examine how institutional structures like contract enforcement mechanisms influence the behaviour of earnings management of banks in addition to how it conditions the bank earnings management-performance relationship. In all, three broad themes are employed to investigate the function of standards for reporting and auditing as

well as contracting institutions in the earnings management-bank performance relationship in sub-Saharan Africa. The specific rationale for each theme is explained below:

SARS and earnings management of banks in SSA

By employing SSA as the study context, this study offers a different perspective on how compliance with ARs could alter the extent of earnings management of banks. Previous studies on Africa like Amidu and Issahaku (2019) have only examined how IFRS adoption but not compliance affects the earnings management of banks in Africa. In this regard, this study provides new insights because IFRS adoption in an economy may not imply that ARS are adhered to in that economy (Adela et al., 2022). Again, even though accounting tradition could complement or substitute auditing and reporting standards in reducing the extent of earnings management, extant literature has neglected how traditions of accounting could influence the relationship between ARS and earning management of banks. By focusing on this gap, this study makes another contribution to extant literature examining whether accounting tradition conditions the relationship between compliance to ARS and bank performance.

Contracting institutions, political institutions and earnings management of banks in SSA

It has been well-documented that firms in economies with weak institutional settings are highly susceptible to information opacity while firms in economies with strong institutional settings are not (Yue, Zhang & Zhong, 2022). Based on the premise that Loan Loss Provision (LLP) information influences the perceptions of market participants on a bank's liquidity, bank

managers ought to provide rewards for controlling income in order to enhance their stability. Contracts between depositors and banks to some extents are accounting-information based, and consequently, banks will probably control profits to prevent paying large interest on deposits (Tran & Ashraf, 2018). However, if there were contract enforcement mechanisms among the several contracting parties of a bank, the bank itself is likely not to engage in information asymmetry behaviour. These arguments naturally lead to the prediction that contracting institutions, which ensure contract performance among contracting parties, could lessen the magnitude of banks' earnings management practices.

This research offers a distinctive perspective by investigating the connection between contracting institutions and the earnings management of banks because extant literature does not analyse the effect of a cluster of contracting institutions on earnings management, particularly for banks. The significance of this contribution is underpinned by theoretical arguments on how institutional structures are vital to firms in the financial sector (La Porta et al., 1997; Beck, Demirgüç-Kunt & Levine, 2003; and Rajan & Zingales, 2003). Further, this research investigates if the connection between contracting institutions and the earnings management of banks depends on political institutions. As far as is known, the research therefore offers empirical support with regard to the Hierarchy of Institutions Hypothesis (HIH) in the context of accounting research. Acemoglu et al. (2005) introduced the HIH, a contemporary theoretical theory that suggests that the effectiveness of certain institutional structures is dependent on other institutional structures.

The role of auditing and reporting standards and contracting institutions in the relationship between earnings management and the performance of banks

Assessing the moderating role of contracting institutions and SARS in the link between performance and earnings management is motivated by the burgeoning theoretical and empirical debate on the earnings management-performance nexus. The positive accounting theory provides reasons why The connection between company performance and earnings management can be inconclusive. Several studies find a positive relationship (Ngunjiri, 2017; Fang, 2008), while some find a negative relationship (Debnath, 2017; Alhadab & Al-Own, 2017), and finally, some find insignificant or mixed results within the same study (Moshi, 2016; Lee, Li, & Yue, 2006). Some studies attribute the differences in findings in terms of evaluating earnings management, the type of firm, the estimations techniques and the presence of some other factors that could moderate the relationship. This study aligns itself with the last school of thought to examine how and why contracting institutions and SARS could explain the disparities in the management of earnings and performance banks performance.

In this regard, the relevance of this study springs from examining The connection between earnings management and performance in an institutional context where the strength of ARS and contracting institutions are fundamentally different from that of advanced countries. Even though previous studies might have examined how the earnings management-performance relationship of non-financial firms is confounded by other institutional factors, the context of banks in SSA region represents a setting

where the implementation or the strength of institutional structures is weaker than that of advanced economies. As different from existing literature (*see* Adela et al., 2022), this study pays attention to specific institutional structures like contracting institutions and the SARS. Contracting institutions have been theoretically maintained to be essential while lowering agencycost among the nexus of firm contracts and therefore could matter to the earnings management-bank performance nexus between depositors and banks. Also, accounting and reporting standards can enhance transparency and aid banks to achieve efficiency outcomes of earnings management, which then leads to an increase in bank performance.

Purpose of the Study

The goal of the research is to examine a few institutional structures' function (auditing and reporting standards, contracting institutions and political institutions) in the earnings management-performance nexus of in sub-Saharan Africa's banks.

Research Objectives

In achieving the study purpose, the study employed the following objectives:

1. To assess the impact of stricter reporting and auditing standards on earnings management of banks in SSA
2. To determine the influence of contracting institutions and political institutions on earnings management of banks in SSA.
3. To analyse the role of auditing and reporting standards and contracting institutions in the banks' earnings management-performance relationship.

Research Hypotheses

1. H1a: SARS has an adverse impact on the earnings management of banks in SSA.

   H1b: The negative effect of SARS on banks' earnings management in SSA is more profound in common law legal origin economies.

2. H2: A negative relationship exists among contracting institutions, political institutions and earnings management of banks in SSA.

H2a: Contracting institutions have an adverse impact on the earnings management of banks in SSA.

H2b: Strong political institutions have an adverse impact on the earnings management of banks in SSA.

H2c: Strong political institutions negatively moderate the connection between SSA banks' earnings management and contracting institutions.

3. H3: Auditing and how bank performance in SSA is related to earnings management significantly moderate the link between banks' effectiveness in SSA and earnings management

H3a: Earnings management has a significant effect on the performance of banks in SSA.

H3b: Auditing and reporting standards positively moderates the banks' earnings management - performance relationship in SSA.

H3c: Contracting institutions positively moderate the banks' earnings management - performance relationship in SSA.

Significance of the Study

In all, addressing earnings management in SSA's banking sector can have a positive ripple effect on various SDGs. It promotes economic growth,

reduces poverty and inequalities, strengthens institutions, and fosters partnerships, ultimately contributing to the region's progress toward sustainable development.

Addressing earnings management can lead to a more stable and transparent financial system, This can therefore make financing more accessible for individuals and businesses. Improved access to credit can empower people to start or expand businesses, invest in education, and access financial resources to improve their livelihoods, ultimately contributing to poverty reduction. A transparent and healthy banking sector ensures that financial resources are allocated efficiently, and investments are directed toward productive sectors of the economy. This can result in job creation, increased economic activity, and ultimately, decent work opportunities for the population. Moreover, transparent financial practices can attract both domestic and foreign investment, which is crucial for infrastructure development and fostering innovation. Robust financial intermediation helps fund large-scale infrastructural projects, including energy systems, communication technology, and transportation networks, contributing to SDG 9's objectives namely industries innovation and infrastructure.

Earnings management practices can exacerbate economic inequalities by channelling resources toward entities that engage in such practices, creating an uneven playing field. Addressing earnings management promotes economic fairness by ensuring that financial institutions operate transparently and allocate resources based on merit rather than manipulation. Also, effective regulation and oversight of the banking sector to combat earnings management contribute to strong and accountable institutions. Reducing corruption and

enhancing transparency in the financial industry helps build trust in institutions, uphold the rule of law, and promote stability and justice, which are central to the SDG 16 goals namely peace, justice and strong institutions. Additionally, tackling earnings management often requires collaboration among different stakeholders, such as governmental organizations, oversight agencies, financial institutions, and international organizations. Strengthening partnerships and cooperation in addressing this issue reflects the spirit of SDG 17, which emphasizes the importance of global cooperation and multi-stakeholder engagement in achieving all the SDGs.

A number of theoretical, empirical and policy contributions has been made by this study. The proponents of the positive accounting theory suggest that people and organizations are self-interested and logical and therefore would select accounting procedures and rules that will maximize their own wealth or utility. Thus, positive accounting theorist will note from this thesis that earnings management can lead to improved bank performance. Institutional theorist contend that institutional structures shape the behaviour of economic agents therefore they may realise from this thesis that institutional structures like SARS and contracting institutions influences earnings management behaviour of banks. Also, these institutional structures influence the extent to which earnings management improves bank performance. The following specific contributions are made by this study:

- this study is the first to examine how compliance to ARS could alter the extent of earnings management of banks. Previous studies on Africa like Amidu and Issahaku (2019) have only examined how IFRS

adoption but not compliance affects earnings management of banks in Africa.

- this thesis is therefore the foremost to look at how contracting institutions is related to earnings management of banks. This study distinguishes itself from other studies that have examined the relationships between other institutional structures and earnings management of banks.
- by examining the role of strength of auditing and reporting standards as well as contracting institutions on the banks' earnings management – performance relationship in SSA, the study provides the first-time evidence on how SARS and contracting institutions make earnings management more efficient in achieving bank outcomes like performance.

The study also has social significance. On the overall, given that earnings management better enhances bank performance in the presence of strong auditing standards, reporting standards and contracting institutions, the effort by stakeholders and regulators in strengthening these institutional structures should not be underestimated.

Limitations of the Study

There are a number of important limits to the research of earnings management and bank performance in Sub-Saharan Africa (SSA), especially when taking into account the moderating impacts of SARS and contracting institutions. These constraints should be carefully considered. The study's generalizability and robustness may be impacted by several limitations, which mostly cover methodological. A major methodological constraint is to the

availability and quality of data. Inconsistent reporting guidelines and restricted data accessibility are frequent problems for the SSA banking industry. Cross-country comparisons are especially difficult since financial data may be lacking or presented according to various accounting rules in different nations. Furthermore, these data restrictions may impair the quality of profits management measurements, which might have an impact on the conclusions' dependability.

Delimitations of the Study

The final sample to evaluate the study's models was drawn from a number of data sources but spans from 2007 to 2021. The data begins until 2007, for two main reasons. First, the acceptance of IFRS and auditing standards in most sub-Saharan economies began in 2007. The data span ends in 2021 because of the data unavailability after 2021. Even though other variables employed in the study has a relatively wider data span, examining the relationships among all the variables, including SARS will require that all of them be brought to the same data span.

Organisation of the Study

This study is arranged into seven chapters. Specifically, chapters four, five and six represent the main themes for the study and are therefore presented in empirical chapter format. The introduction, literature review, creation of hypotheses, research methods, findings and discussion, summary, and conclusions are all unique to each empirical chapter. The three empirical chapters together examine the role of SARS and contracting institutions in The connection between bank performance and earnings management. The general outline of the study is as follows:

The introductory chapter lays the groundwork for the research, outlining its context, significance, and key objectives. It delineates the central research questions, outlining the testable hypotheses, and acknowledging the study's limitations, and provides a roadmap for the subsequent chapters.

Following this, an extensive literature review explores the conceptual underpinnings of auditing and reporting standards, contracting institutions, earnings management and bank performance. Chapter two also examines relevant theoretical models, including those related to accounting practices, principal-agent theories, stakeholder theories, institutional theories and the hierarchy of institutions hypothesis.

The methodology section in chapter 3 outlines the overall research approach, detailing the philosophical stance, research design, and data collection methods. While specific analytical techniques are elaborated upon in later chapters, this section provides an overview of the general methodological framework guiding the study.

The first empirical chapter investigates how the robustness of auditing and reporting standards influences earnings management practices in sub-Saharan African banks. Utilizing advanced econometric techniques, the analysis reveals a significant inverse relationship between stringent standards and earnings manipulation, with this effect being more pronounced in common law jurisdictions.

The subsequent chapter examines the interplay among contractual institutions, political structures, and earnings management in sub-Saharan African banks. Findings indicate that well-developed contractual frameworks

generally discourage earnings manipulation, particularly in countries with strong political institutions.

The final empirical chapter explores how auditing standards and reporting standards as well as contractual institutions moderate the relationship between earnings management and bank performance. Results suggest a favourable correlation between performance and earnings management, with both institutional factors generally enhancing this relationship.

The concluding chapter synthesizes the key findings from the empirical analyses, revisits the initial hypotheses, and discusses the research's theoretical and practical ramifications. It also offers policy recommendations and identifies avenues for future investigation in this field.

CHAPTER TWO

CONCEPTUAL AND THEORETICAL REVIEW

Introduction

This chapter provides an overview of the key concepts employed in this thesis. This is meant to give readers a general idea of the different concepts employed in each empirical chapter's literature review. In order to give a solid foundation for comprehending the relationships among strength of auditing and reporting standards, contracting institutions, earnings management and performance of banks, the chapter also presents an analysis of the underlying theory of the relationships.

Conceptual Review

Earnings Management in the Banking Sector

The operations of banks are essentially distinct from that of non-financial firm when it comes to financial reporting. Basically, since financial reporting is aimed at enhancing transparency, compliance to ARs could be regarded as a good corporate act. However, within the financial sector, arguments have been advanced for and against high level of transparency. For instance, Dang and Nguyen (2023) argues that high level of transparency in bank financial reporting may expose the bank to public scrutiny, and that anytime there is a liquidity mismatch between liabilities and assets of banks, depositor confidence may be severely dampened, and this may lead to unintended consequences like bank runs.

Quality financial reporting may not be optimal for banks. Banks usually trade debt securities, and these debt securities need not be sensitive to information. To explain this, Holmstrom (2009) provides an illustration with

the market for sale of diamonds. He explains that if buyers are given the chance to inspect diamonds before the actual transaction, then market liquidity could reduce and eventually make the market inefficient. Holmstrom (2009) then argues that this may be a reason why banks in the United States were not mandated to provide full disclosure until the year 1974. This was supported by the argument that adverse macroeconomic conditions could make depositors panic about their deposits and this problem is exacerbated when banks are very transparent in their reporting.

Conversely, those who argue in favour of bank transparency highlight that transparency is important to enable depositors monitor the lending quality of the bank (Freixas & Rochet, 2008). In addition, bank transparency would reduce agency problems among the multiple parties to bank and this could increase bank efficiency. This is because, when there is a high level of imbalance of information between the bank and its several stakeholders, the cost of equity and debt is likely to increase (Fosu, Ntim, Coffie & Murinde, 2017). From the regulators perspective, quality bank financial reporting alone could complement their monitoring role and avoid regulatory sanctions that could be imposed on banks as a result of not meeting regulatory requirement.

Within the banking sector, provisions for loan loss have become the focal point of accounting research concerning earnings management (Beatty & Liao, 2014). Financial institutions often utilize the discretionary aspect of using loan loss provisions to inflate profits while maintaining the appearance of transparency demanded by regulatory bodies and other stakeholders (Liu & Ryan, 2006). According to Beatty and Liao (2014), the motivations behind

such discretionary practices can be broadly categorized into earnings-related and capital-related objectives.

Bank executives typically employ loan loss provisions' optional component to accomplish earnings smoothing over time. The preference for employing provisions for discretionary loan loss (DLLP) rather than real loan loss provisions as a gauge of banking industry earnings management is underpinned by several key factors. Firstly, loan loss provisions involve significant managerial judgment and discretion in their estimation (Beatty & Liao, 2014). Banks are required to allocate provisions for potentially uncollectible loans based on their assessment of credit risk in their loan portfolios, a process that allows for discretionary decision-making.

Secondly, the accrual-based nature of loan loss provisions, where they are recorded before actual loan losses materialize, provides bank managers with greater flexibility to adjust reported earnings (Kanagaretnam et al., 2004). This contrasts with actual loan losses, which are recognized at the time of occurrence. Thirdly, by modifying the DLLP, bank managers can mitigate fluctuations in indicated income over time (Greenawalt & Sinkey, 1988).. An increase or decrease in DLLP correspondingly reduces or increases the current period's net income. Banks may be incentivized to smooth earnings to maintain a stable or upward trend, potentially influencing stock prices, executive compensation, and regulatory oversight.

While actual loan loss provisions are significant, they are less commonly used as an earnings management metric due to their representation of realized losses, which are less susceptible to managerial discretion and are recognized retrospectively (Kanagaretnam et al., 2003). The subsequent

empirical chapters in this study provide detailed explanations of the methodologies used to estimate DLLP.

Accounting Practices and Regulatory Frameworks in African Nations

The evolution of financial reporting in Africa reflects the lasting influence of colonial powers. Two primary trajectories emerged: one shaped by Common Law traditions, prevalent in Anglophone regions, and another moulded by Code Law systems in Francophone areas.

In Anglophone Africa, the Common Law approach fostered the establishment of autonomous chartered accountancy organizations. This system emphasised transparency and comprehensive disclosure for shareholders not directly involved in company operations. Conversely, Francophone African nations, adhering to Code Law principles, developed accounting practices through legislative measures. These regulations were primarily designed to align with governmental objectives and tax computations, reflecting a context where investors, particularly banks, maintained closer ties with businesses.

A significant milestone in African accounting was the establishment of the Pan-African Accountancy Federation in 2011. This organization, comprising 54 member bodies from 43 countries and representing approximately 11,000 professionals, aims to enhance governance, financial management and answerability both private and public sectors.

International Financial Reporting Standards (IFRS) adoption signifies another crucial development. By 2018, a vast majority of African jurisdictions using IFRS mandated publicly listed entities should follow these international standards while preparing audited financial statements.

Africa's unique socioeconomic landscape, cultural diversity, and business environments provide a distinctive context for examining the impact of auditing and reporting standards. Recent studies conceptualize these standards as encompassing compliance with various financial regulations, with particular emphasis on International Standards on Auditing and IFRS.

Empirical evidence suggests that the SARS in sub-Saharan African economies is moderately above average (see Adela et al., 2022). This finding underscores the ongoing efforts to enhance financial transparency and accountability across the continent, while also highlighting areas for potential improvement in regulatory frameworks and compliance mechanisms.

Contracting Institutions

Acemoglu and Johnson (2005) "define contracting institutions as the rules and regulations governing contracting between ordinary citizens, for example, between a creditor and a debtor or a supplier and its customers". Thus, aspects of contracting institutions include creditor right protection, contract enforcement, judicial independence and reliability of the police (*see* Jensen & Meckling;1976, Acemoglu & Johnson, 2005). Creditor right protection is a contracting institution because they determine the extent to which creditor rights are safeguarded in an economy. In that regard, can alter the incentives of creditors to monitor, enforce loan contracts and to recontract.

The number and cost of legal procedures is also very vital in ensuring that contract between two parties is enforced. An environment of trust and certainty is created in a less costly contract enforcement environment (Sheng, Zhou, Li, & Guo, 2018). If the number of legal procedures needed to follow to enforce contracts is high, the ability of several stakeholder of a bank to

demand accountability may be severely dampened and this could breed earnings management behaviour.

Procedure-wise, the impartiality and neutrality of judges comprise the independence of the court. According to Sopilnyk and Piwowarski (2021), evaluating a court's independence requires consideration of several factors, such as the hiring procedure, the length of the position, both external signs of independence and safeguards against outside coercion. An essential right of everyone who engages in any form of business contract is to gain access to a fair and equitable public hearing. Finally, there is a general assumption that there is less likelihood to committing a crime when the policing mechanism is reliable (Lo, 2008). Jensen and Meckling (1976) gave an earlier exposition by pointing out that the police have state powers that allow them to ensure contract performance or to ensure the reimbursement of damages due to contract non-performance. In line with this, reliability of police could be deemed as a contracting institution.

Bank Performance

A bank's operations and financial health are covered under the multifaceted concept of bank performance. It is a crucial element in determining a financial institution's sustainability, financial success, and general performance. The bank concept performance is inextricably tied to a number of theoretical models and empirical research that have influenced how we see this phenomenon.

Empirical studies have explored various aspects of bank performance, including profitability, efficiency, and risk management. Profitability, often measured by indicators such as net interest margin, return on equity (ROE),

and return on assets (ROA), are the widely used metrics for assessing bank performance (Dietrich & Wanzenried, 2011). Ex-post metrics of bank performance are ROA and ROE whilst NIM is an ex-ante measure. The main revenue generation item for banks is the Net interest margins they receive on loans. Since NIM does not include a deduction of LLP, it represents An indicator of financial performance before the recognition of LLP in the income statement. Notwithstanding, the amount of LLP to some extent shows bank risk in collection of debt and therefore can be related to the interest charged on loans.

ROE shows the profitability of equity holders' investment. To the degree that managers may exaggerate the company's earning to attract more investors, earnings management could affect returns on equity investment. Finally, ROA reflects how well the business has performed in the utilization of the capital provided by both insiders and outsiders (Rashid, 2020). A natural assumption here is that the effect of EM on ROA reflects how EM sends a signal to all financiers of a bank. In this research, we mainly conceptualized ROA as the metric of bank performance.

Political Institutions

Politicians' and bureaucrats' arbitrary use of power is restrained according to political associations (Acemoglu et al., 2005). This happens through delineating the borders between private and public property rights and putting in place protocols for their preservation. This indicates that in economies where political officials primarily misuse their authority to prevent common individuals from enforcing contracts, political institutions may be weak. According to Acemoglu & Robinson (2003), political institutions are

understood in this study as institutional structures that dictate the future distribution of political power.

This conceptualization is crucial because it makes clear the tremendous desire of economic agents to change political institutions at whatever chance they have. Based on the assumption that economic agents are rational, their opportunistic behaviour could be heightened when political institutions are weak" This study conceptualizes political institutions as political rights and political stability in the context of earnings management and bank performance, in accordance with Lemma, Lulseged, Mlilo, and Negash (2020). Political stability could affect the earnings management and performance of banks because firms usually increase cash holdings due to uncertainties in weak political stability regimes, raising the agency cost associated with free cashflow and eventually incentivize managers to manage earnings (Julio & Yook, 2012). Robust political rights reduce earnings management by increasing financial transaction openness (Trueman & Titman, 1988). This is because they may function as a check on bank operations and restrict bank managers' capacity to manipulate their revenues when the media and other organizations that promote accountability flourish under robust political rights regimes.

Theoretical Review

Positive Accounting Theory

The goal of the Positive Accounting Theory (PAT), a theoretical framework created by Watts and Zimmerman (1978), is to forecast and explain how people and organizations will behave when it comes to financial reporting and accounting procedures. The idea behind the theory is that since people and organizations are self-interested and logical, they would select accounting procedures and rules that will maximize their own wealth or utility. The idea of opportunistic behaviour, which contends that managers may use earnings management to accomplish goals like hitting or exceeding earnings targets, optimizing their pay, or staying out of debt covenant violations, is one of the fundamental principles of PAT (Watts & Zimmerman, 1986). Earnings management in the banking industry can significantly affect how well the banks function.

PAT claims that banks may use earnings management techniques to satisfy regulatory capital needs or to reassure depositors and investors about their sound financial standing (Beatty et al., 1995). It may be accomplished in several ways, such as securitization transactions, adjustments to fair value and the acknowledgment of loan loss provisions (Laeven & Majnoni, 2003). Banks have the capacity to control reported capital ratios and profitability through earnings management, which might have an impact on the overall health of the bank performance and investor trust. Conversely, overzealous earnings management may eventually be harmful to a bank's success. Healy and Wahlen (1999) assert that earnings management can undermine investor trust,

change the financial statements' information content, result in poor judgments about resource allocation and eventually harm bank performance.

Agency and Stakeholder Theories

A popular theoretical framework in accounting and corporate governance studies is agency theory (Jensen & Meckling, 1976). It implies that because ownership and control are separated in contemporary organizations, there may be a conflict between agents (like managers) and principals (like shareholders). As agents, managers may engage in opportunistic behavior, such as earnings management, to enhance their own interests at the expense of the principals' interests (Healy & Wahlen, 1999).

Because of the complexity of financial instruments and the opaque nature of banking activities, agency problems can be more pronounced in the context of banks (Levine, 2004). Managers could be encouraged to participate in earnings management strategies to influence contractual outcomes, show profitability to the market, or meet with regulatory capital requirements (Beatty and Liao, 2014). The compliance to auditing and reporting standards can be viewed as mechanisms to mitigate agency problems and promote transparency in financial reporting. Reporting standards aim to enhance the quality and comparability of financial statements by removing the information asymmetry that exists between management and shareholders. (Barth et al., 2008). In addition, auditing standards set out requirements for auditors to guarantee the accuracy and legitimacy of financial data (International Federation of Accountants, 2021). By raising the standard of financial documentation and auditing procedures, both auditing and reporting standards have the ability to restrict opportunistic earnings management.

An additional viewpoint on the connection between SARS and bank earnings management is offered by stakeholder theory. According to this perspective, businesses should take into account the interests of all parties involved when making decisions, and not only the interests of shareholders (Freeman et al., 2010). Shareholders, depositors, regulators, staff members, and the general public are some of the stakeholders in the banking sector. Stakeholders may see bank earnings management as a technique that favours the interests of some stakeholders—such as shareholders—over those of other stakeholders—such as depositors and regulators (Mulford & Comiskey, 2005). The genuine financial performance of banks may be distorted by earnings management, which might mislead stakeholders and impair their capacity for making sound economic decisions.

One way to improve transparency to stakeholders is through the implementation of reporting and auditing standards. The goal of reporting standards is to give stakeholders high-quality, comprehensible, and transparent financial information (Barth et al., 2008). Comparably, auditing standards safeguard the interests of numerous stakeholders while advancing the accuracy and dependability of audited financial accounts (International Federation of Accountants, 2021). Auditing and reporting standards have the ability to decrease the unintended consequences of earnings management (Kanagaretnam et al., 2014). This will increase stakeholder confidence and eventually improve bank performance.

New Institutional Theory

Williamson (1981) coined the term "new institutional theory" in his works Markets and Hierarchies: Analysis and Antitrust Implications. The New Institutional Economics (NIE) can be traced back to Coase's lectures in 1937

and 1960. Coase's theories—that firms exist to lower transaction costs and that the institutional framework in which economic players interact determines transaction costs—were the foundation of the New Institutional Economics movement. Transaction cost economics (TCE), which aimed to examine the rationale behind the form and organization of contemporary economic transactions, is a significant offshoot of Coase's seminal concept (Williamson, 1994). The TCE contend that while market transactions have costs, these costs may be reduced by use of non-market procedures (Coase, 1937; Williamson, 1975).

These are the expenses associated with planning, enforcing, settling, and securing business contracts (Williamson, 1989). Because of this, the relative benefits of any given arrangement can only be evaluated by comparison, which also considers the features of the transactions and the institutional context in which they occur. Afterwards, institutions were defined by North (1991) as “the humanly devised constraints that structure political, economic and social interaction” (p.97). Regarding institutions' significance, he proffered that “institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline” (p.97).

New institutionalists recommend strengthening two groups of institutions to address opportunistic behaviours of economic agents. First, those that promote confidence and reduce transaction costs in order to promote trade. Contracts and their enforcement procedures fall under this category. Second, institutional structures that exert pressure on the government and other state power brokers to defend individuals and their property rather than

enslaving them (Ménard & Shirley 2005). This study dwells on the contract enforcement institutions. Consistent with the theory, this research argues that contract enforcement mechanisms such as creditor right protection, legal procedures in enforcing contracts, judicial independence and reliability of police can help align the interests of managers with firm stakeholders, thereby reducing the incentives for opportunistic behavior (Jensen & Meckling, 1976) like earnings management which could lead to unintended consequences like a fall in firm performance.

Hierarchy of Institutions Hypothesis

According to Acemoglu, Robinson, and Johnson (2005), the idea of institutional hierarchy implies a structured link between various kinds of institutions. This framework posits that political structures are essential in figuring out the effectiveness of economic institutions in shaping financial outcomes. Economic institutions, serving as primary sources of incentives and constraints for market participants, directly influence economic activities and results. Olaoye and Aderajo (2020) highlight how this hierarchy manifests in resource allocation, often favouring economic actors with greater political clout.

This hierarchical structure permeates various aspects of economic interactions, illustrating the cascading effect of political institutions on both economic frameworks and outcomes (Hartwell, 2018). Magnin (2018) elaborates on this concept, noting that dominant institutions at the apex of the hierarchy can either reinforce or undermine lower-tier institutions. According to the hypothesis, institutions at a higher level can influence how lower level institutions affect economic outcomes.

In the context of this research, contracting institutions are viewed as a subset of economic institutions, as they establish the incentive and constraint structure for economic agents engaged in contractual relationships. Applying the hierarchy of institutions theory to this study, we explore how for instance creditor rights enforcement might inhibit earnings management practices in politically connected banks. Similarly, this theory offers insights into the potential for judicial independence to effectively curb earnings manipulation when buttressed by robust political institutions. Ultimately, the hierarchy of institutions framework provides a lens through which to examine how political structures influence the efficacy of contracting institutions in mitigating earnings management behaviours.

Chapter Summary

The chapter provided the theoretical and conceptual review on the relationships among strength of auditing and reporting standards, contracting institutions, earnings management and performance of banks. The theoretical review focused on four main theoretical underpinnings – Positive Accounting theory, Agency theory, Stakeholder Theory, The Hierarchy of Institutions Hypothesis and the New Institutional Theory. Insights into the connection between bank performance and earnings management were offered by the positive accounting theory. The relationship between bank performance and earnings management is moderated by contracting institutions and SARS, as explained by the new institutional theories. Explaining the connection between SARS and bank earnings management were the agency and stakeholder theories. The HIH explains why political institutions influence the relationship between contracting institutions and bank earnings management.

CHAPTER THREE

RESEARCH METHODS

Introduction

An outline of the general method used in this research is provided in this section. The three empirical studies in Chapters four, five, and six include the full econometric, methodology, data sources and variable measurement, model specification, and estimation procedure for each objective. This chapter starts out by outlining the philosophical position of the study, before going on to discuss the study design and approach of the research. Next, the study provides a justification for the data screening procedure and finally, the choice of system generalized method of moments as the primary technique for estimate.

Research Philosophy

Newsome et al. (2003) points out that the philosophy of a research reveals the actual bounds within which the researcher's area functions and its associated view of reality. Research philosophy also encompasses the inquiry norms, standards, modes and a number of methodologies, which altogether ensure that the generation of knowledge are in line with the assumptions of the philosophy. Mostly, there are binary main research philosophies usually employed in business research – interpretivism and positivism (Saunders & Lewis, 2017). This research is grounded on the positivist philosophy. Collis and Hussey (2014) argue that there are four main pillars of these two research philosophies, i.e., epistemology, ontology, axiology and research methodology. Based on these four pillars, this thesis clearly aligns itself with the positivist philosophy.

First, epistemology shows how the researcher is related to the phenomenon being studied (Collis & Hussey, 2014). Within the positivist philosophy, it is assumed that the knowledge being produced should be independent of the researcher. Unlike the interpretivism philosophy that incorporates the culture, values, experience and believes of the researcher in the production of knowledge (Kivunja et al., 2017), the positivist philosophy rather takes a purely scientific approach in observing social reality (Gunbayi & Sorm, 2018). Thus, positivists believe that measuring and observing a social reality using a method which is independent of the research will produce credible knowledge (Collis & Hussey, 2014). Therefore, positivist usually employ scientific methods similar to those in the hard sciences, to establish causal relationships to eventually produce lawlike generalizations (Saunders & Lewis, 2017). The methods employed are thus objective (Collis & Hussey, 2014).

This research grounded in positivism and therefore measures strength of auditing and reporting standards, contracting institutions, earnings management and bank performance objectively by employing generally accepted quantitative methods. Afterwards, based on the positivist philosophy, the researcher employs regression technique to establish relationship among the variables of the study. By employing regression analyses, the researcher becomes independent of the relationships being studied.

Second, Ontology points out how the researcher perceives the concept of reality (Collis & Hussey, 2014). Positivists ontology assumes that reality is impartial and therefore ought to be unaffected by how the researcher perceives it. Thus, when research adopts the positivist philosophy, the researcher and

any other researcher should have the same perception of the reality being observed (Saunders & Lewis, 2017). Since this thesis relies on the positivist philosophy, the researcher believes the reality about strength of auditing and reporting standards, contracting institutions, earnings management and bank performance is the same, and does not depend on other subjects within the reality's context. Thus, data on the study variables are not obtained through questionnaires but objectively from global competitiveness reports, world doing business reports, annual reports of banks and world development indicators dataset. These data sources provide objective data irrespective of how the researcher or other researchers regard the quality of the SARS, contracting institutions, earnings management and bank performance. Specifically, for the earning management variables, the study employs an objective earnings management model to measure it.

Third, axiology shows the importance of ethics and values in the entire research process, including the researcher's own ethics and values influencing the outcome of the research (Saunders & Lewis, 2017). Since positivists are objective in the research epistemology and ontology, it is cogent to assume that they employ data and methods that are not influenced by human bias (Kivunja et al., 2017). By employing regression analysis, the findings from the data analysis are expressed in numbers. Since the sign, magnitude and statistical significance is determined by the regression analysis, the findings from the study are free from researcher's own bias.

Fourth, in terms of the methodological assumption, positivist employ deductive methods to research into a phenomenon (Saunders & Lewis, 2017). Thus, positivists begin by analysing existing theories, relate them to the

subject being studied, state a number of hypotheses from the prevailing theories and empirical literature, and finally test these hypotheses to make generalisations (Collis & Hussey, 2014). In addition, in testing hypothesis, positivist researchers may study the "cause-and-effect" association between the variables. Usually, these cause-and-effect relationships are pre-established from existing theories. Based on the deductive methodological assumption, this study reviewed the agency and stakeholder theories, positive accounting theory and the new institutional theory. Afterwards, the study developed a number of research hypotheses based on the arguments of these theories. Finally, the study measured the variables in the hypotheses objectively, used mathematical methods like regression to estimates the results and then making conclusion on the hypotheses. By this methodology researcher would have deduced knowledge from existing literature.

Research Design

The study's overall research approach may be influenced by the study design that is selected. The overall framework for the research as well as a method for gathering, measuring, and analysing data are known as the research design (Kothari, 2004). In a theoretical model, the cause and effect of one or more explanatory factors on a response variable are examined by employing the explanatory research design (Saunders & Bezzina, 2015). Causal research design is crucial in evaluating theoretical predictions in this work. This is due to the research's examination of "cause-and-effect" relationships among strength of auditing and reporting standards, contracting institutions, earnings management and bank performance.

Research Approach

Saunders and Lewis (2017) identify research approach as the procedure that are employed to test the theories or provide answers to the critical question in the research as well as enables the researcher to accept or reject the research hypotheses. The quantitative approach flows from the deductive methodological assumption since hypotheses testing involves the use of quantitative techniques. Also, the quantitative approach involves a set of strategies aimed at obtaining and analysing numerical data to test the validity of the theories employed (Collis & Hussey, 2014). Creswell & Creswell (2017) pinpoints that the quantitative research approach dwells on objective empirical analysis of objective reality, test and understand how the variables that underpin the research are related. Thus, the quantitative research approach employs mathematical and statistical methods to analyse the degree and direction of causality between the dependent and the independent variables (Creswell & Creswell, 2017). To achieve the objective set from the beginning of the study, this thesis adopted the quantitative approach. As a matter of evidence, this research employs the quantitative approach to analyse the relationships among strength of auditing and reporting standards, contracting institutions, earnings management and bank performance, and test the hypotheses that were deducted from the theories. The sources of the data were purely quantitative, and regression analyses were employed to provide empirical evidence on the research hypotheses.

Data Sources and Data Screening Procedure

The final sample used to examine the relationships among strength of auditing and reporting standards, contracting institutions, earnings

management and bank performance, was drawn from a number of data sources but spans from 2007 to 2021. The data begins from year 2007 for two key reasons. First, the adoption of IFRS and auditing standards in most sub-Saharan economies began in 2007. Since then, most firms, whether financial or non-financial have taken steps to implement these standards. Therefore, the SARS data was collected from 2007 since this will give a good data coverage. The data span ends in 2021 because of the data unavailability after 2021. Even though other variables employed in the study has a relatively wider data span, examining the relationships among all the variables, including SARS will require that all of them be brought to the same data span. Thus, the following data screening procedure was employed.

The study employs data from the country level as well as the bank level. The bank level data was obtained from bankscope, after which we used the following criteria (same approach was employed by Beck et al., 2013 and Yin, 2021) to screen the data to come out with a final sample of banks in across SSA economies: (1) To avoid data duplication, we include only consolidated data for banks that have data for several branches (2) We obtain country-level data for variables like strength of auditing and reporting standards and contracting institutions from Global competitiveness index report and world doing business database respectively. Thus, the final sample for each objective were obtained by merging the bank level data and the country-level data spanning 2007 – 2021. The details of the measurement for each variable are presented in the subsequently empirical chapters – chapters four, five and six.

Estimation Technique

The study adjusted for potential biases in the estimates caused by individual country heterogeneity which is not taken into account in cross-sectional and time-series regression, by making the use of panel data methods (Agyei, Marfo-Yiadom, Ansong, & Idun, 2020). As later will be revealed in the empirical chapters, the two dependent variables employed in this research are found to be highly correlated with their one-year lag. This allows the study to assume that return on asset as well as earnings management are persistent and autoregressive. As a consequence of the dependent variables' autoregressive nature, static panel models are ineffective for estimating the models.

The fixed effect and random effect estimators assume the country-specific effect (η_i) to be strictly exogenous. The former views the country-specific effects as a nuisance parameter, whereas the later views it as random and, hence, uncorrelated with the error term. This requirement, however, accounts for the difference between the two. In this regard, general least square regression (GLS) may be the suitable technique for evaluating the random effect model. The fixed effect removes η_i through within transformation and applying a pooled OLS estimator called fixed effects estimator or within estimator. The unobserved country-specific fixed effect can also be addressed by including cross-sectional dummies in each country and estimating in addition to the other dependent variables. This is referred to as the least squares dummy variable fixed effect (Verbeek, 2008) or the dummy variable regression (Wooldridge, 2009). However, this subsequent approach has the problem of producing large values for the explanatory power

of the model (high R-square and F-statistic) when the number of countries is large. This may be quite deceptive.

Strict exogeneity is the fundamental presumption of the fixed effect model. This indicates that the explanatory factors cannot be dependent on the error term's values in the past or future. Thus, this assumption is broken by including the lag of the dependent variable (Verbeek, 2008). Hsiao (2001) claims that consistency with the conventional inside transformation is impossible due to the significant link between the random term and the dependent variable's lag. Moreover, the random effect estimator's premise—that the regressors shouldn't be associated with the error term—is broken by including the lag of the dependent variable. This means that static models (fixed and random effects) do not consider the possibility of a lag dependent structure.

All of the models in the study are estimated using the generalized method of moments (GMM) estimator, which was created by Holtz-Eakin and Rosen (1990), Arellano and Bond (1991), and supplemented by Arellano and Bover (1995) and Blundell and Bond (1998). This approach is consistent with previous earnings management and performance studies.

The objective here is to express the equations as a dynamic panel regression and take the first difference to remove the country-specific effects. The first-difference equation's regressors are then instrumented, supposing that the lag dependent variable is weakly exogenous and that the time-varying disturbances in the original equations are not serially linked. The difference GMM estimation is the term for this. This approach also tackles simultaneity

bias issues (Arellano & Bond, 1991), which are known to be relevant to growth regressions.

If variables are persistent, their lagged values become weak instruments for their differenced series due to the fact that they convey little information about their future changes (Acemoglu & Robinson, 2008). This is likely to be the case for contracting institutions which exhibit persistence once they have been instituted (Law & Azman-Saini 2008). This can introduce bias specifically for small samples (Roodman, 2009a, 2009b). Consequently, the system GMM estimator was proposed by Arellano and Bover (1995), which integrates the first difference and level equations and further leverages the lag difference of the independent variables as an additional tool for the level equation.

Since the system GMM (SGMM) can adjust for biases in the difference estimator, this study employs it. Moreover, a panel structure with more cross-sectional sections (i) than time-series units (t) is better suited for the SGMM instrumental variable panel estimation approach. This study specifically employs more cross-sectional than time-series units. The one-step and two-step estimators are the two SGMM variations that are available. Since the two-step estimator is more asymptotically efficient than the one-step estimator, it was employed in this study. While two-step estimators use optimum matrices in which moment conditions are weighted by a consistent estimate of their covariances, one-step estimators use weighting matrices that are independent of the estimated parameters (Slesman, Baharumshah, & Ra'ees, 2015).

Nonetheless, the reliability of the instruments and the lack of serial correlation are what guarantee the SGMM estimator's consistency. In that sense, two diagnostic tests are used. First, the over-identification limitation tests by Sargan and Hansen, which evaluate the validity of the instruments as the null hypothesis. It is theoretically possible that the development of differencing equations will lead to first-order serial correlation (AR1). Second-order serial correlation (AR2), on the other hand, is concerning as it suggests that there may be a first-order serial correlation at levels or that there may have been a misspecification (Roodman, 2009a). As a result, a formal test of serial correlation at the second order is likewise carried out in the second test. These null hypotheses of the two diagnostic tests must not be rejected.

The study presented an endogeneity among the explanatory variables, to justify the use of SGMM. As presented in below, the null hypothesis of exogeneity was rejected among all the explanatory variables, showing that there is endogeneity among them.

Variables	**DWH Test Coefficient**	**DWH Test P-value**	**Test Results**
SARS	17.114	0.0000	Rejected at 5%
LO	19.221	0.0000	Rejected at 5%
PI	18.422	0.0000	Rejected at 5%
CRP	12.455	0.0000	Rejected at 5%
PR	11.590	0.0001	Rejected at 5%
JI	9.2234	0.0005	Rejected at 5%
CEC	10.221	0.0004	Rejected at 5%
CEP	12.978	0.0000	Rejected at 5%

Chapter Summary

The overall research methodology used to write this thesis was explained in this chapter. As a result, positivism was discussed in the chapter together with the quantitative research technique, explanatory study design, and research philosophy. This chapter also included the data sources and data

filtering process. The chapter concluded with a reason for the selected model estimating method, which was the System Generalized Method of Moment (SGMM).

CHAPTER FOUR

STRENGTH OF AUDITING AND REPORTING STANDARDS AND EARNINGS MANAGEMENT OF BANKS IN SUB-SAHARAN AFRICA

Abstract

This empirical chapter aims to investigate how the strength of reporting and auditing standards affects banks' ability to control earnings in sub-Saharan African nations. This chapter makes use of panel data that includes many accessible bank- and country-level observations from 2007 to 2021. The study used the System Generalized Method of Moments (SGMM) to estimate the impact of SARS on sub-Saharan African banks' earnings management. The findings from the SGMM estimates suggests that strength of Auditing and Reporting Standards has a statistically significant negative relationship with earnings management. After further investigation, the results show that earnings management of banks in countries with a common law accounting heritage are more negatively impacted by the robustness of ARS than are economies with a civil law accounting past. This chapter pertains to emerging nations that want to curtail the degree of earnings manipulation practices inside the banking industry. The foundation of these initiatives is strengthening auditing and reporting standards.

Introduction

Accounting and auditing standards may be adopted by economies for several reasons. However, since auditing and reporting standards generally increase transparency and financial reporting quality, it is likely to reduce the extent of earnings management by managers. To the extent that auditing and reporting standards increase transparency in the preparation and presentation of financial reports, it could alter the incentives of managers to use accounting techniques to overly present a positive view of a company's financial performance and position. The question therefore is whether or not auditing and reporting standards reduce earnings management.

Africa has witnessed a tremendous increase in the adoption of International Financial Reporting Standards (IFRSs) (Tawiah & Boolaky, 2019). Simultaneously, the continent has committed significantly to strengthening auditing standards (*see* Adela et al., 2022). If superior audit quality is very vital to industries characterised by a high level of information uncertainty (Billingsley & Schneller, 2009), then auditing standards should reduce the extent of earnings opacity in the banking industry. Banks by nature, can keep some types of assets and loans off their balance sheet to hold sophisticated financial assets without risking their stability (Tran, Hassan & Houston, 2019). In this regard, earnings management by banks could exacerbate the extent of information asymmetry between stakeholders and the banks themselves, and therefore strong auditing and reporting standards may reduce the monitoring cost of stakeholders.

This thesis is therefore interested in testing the effect of the strength of auditing and reporting standards (hereafter, SARS) on earnings management

of banks in SSA. Assessing the relationship between SARS and the earnings management of banks is particularly relevant to policy owing to top opacity in the banking sector. To avoid bank runs in prevailing circumstances, banks could temper the actual level of accruals to report a desired level of profit (Ozili, 2022). Banks could also manage earnings to meet depositor expectations since depositors represent key stakeholders of banks. In the wake of tightening banking sector regulations, banks may likely face difficult business conditions and survival concerns. The survival concerns could typically incentivise banks to present an overly good impression of reported earnings. Literature documents that bank usually manage loan loss provisions to reduce customers' perception that banks are incurring huge loan losses (*see* Taylor, Awuye & Cudjoe, 2023).

To examine the relationship between auditing and reporting standards and a bank's earnings management, this study relies on the bank level data to measure earnings management. Corollary to a number of literature on bank earnings management, this study employs discretionary Loan Loss Provision (LLP) as a proxy because managers can alter the perception of customers on banks' solvency by managing LLP. Since banks operate within the institutional environment of every economy, this study relies on a country-level measure of compliance with auditing and reporting standards (ARs). Specifically, this study follows recent empirical studies on compliance to auditing and reporting standards and employs SARS as a measure (*see* Adela et al., 2022).

This study takes the examination of the relationship between SARS and bank earnings management further by investigating whether the relationship is

more or less profound under certain conditions. This is because there is evidence that the role played by auditing and reporting standards (hereafter, ARs) in reducing earnings management is only a limited one, as the principle-based nature of standards allow a substantial amount of managerial discretion. However, the extent of the discretion could be underscored by the accounting tradition within which the banks and its stakeholders interact. Even though several economies in the SSA region are gradually converging towards the use of single reporting standards (Adela et al., 2022), the heterogeneity in the efficacy of these standards could be caused by differences in country institutional factors (Jeanjean & Stolowy, 2008). In this regard, this thesis examines whether accounting tradition improve or minimises the effect of SARS on earnings management of banks. La Porta et al. (2002) argue that common law countries are usually characterised by a more protective and effective legal framework relative to civil law origin countries. Therefore, SARS could reduce the extent of banks' earnings management more in the common law regimes than in civil law regimes.

This study makes contribution to existing literature in several ways. First, by employing SSA as the study area, this study offers different perspective on the how compliance with ARs could alter the extent of earnings management of banks. Previous studies on Africa like Amidu and Issahaku (2019) have only examined how IFRS adoption but not compliance affects earnings management of banks in Africa. In this regard, this study provides new insights because IFRS adoption in an economy may not imply that Auditing and Reporting standards are strong in that economy (see Adela et al., 2022). Second, even though accounting tradition could complement or substitute

ARS in reducing the extent of earnings management, extant literature has neglected how traditions in accounting could influence the connection between ARs and earning management of banks. By focusing on this gap, this study makes another contribution to extant literature.

Theoretical Review

Agency Theory and Stakeholder Theories

Agency problems are usually evident when there is separation of ownership and control, as managers may maximise their utility at shareholders' expense (Jensen & Meckling, 1976). In this regard, the board of directors represent front-liners in shareholders' defence against managers' expropriation (Weisbach, 1988). Despite their frontline role, the extent of board effectiveness may depend on their independence and their ability to put in place sub-committees to deal with any possible agency conflicts (Fan, Jiang, Zhang & Zhou, 2019). Some empirical evidence suggests that audit committees could reduce the extent of earnings management. These empirical findings could be premised on the arguments that audit sub-committees ensure corporate transparency, thereby enabling shareholders to enforce contractual obligations of managers (Godfrey, Merrill & Hansen, 2009).

As a result, compliance with IFRS as well as auditing standards could reduce the cost of monitoring management. To the extent that auditing and reporting standards are robust in a country economy, managers are likely to reduce earning management behaviour. Since a firm consist of a nexus of contracts (*see* Jensen & Meckling, 1976), Bartov et al. (2000) argue that managers could temper with earnings numbers to gain in the contracting process. However, compliance with a set of accounting and auditing standards

will increase comparability and pressure managers to minimize the management of earnings management (Van Tendeloo & Vanstraelen, 2005; .Jeanjean & Stolowy, 2008)

The stakeholder theory provides additional cues as to why earnings management is relatively lower in economies that adhere to a set of financial reporting and auditing standards. A clear definition of stakeholders is "Any identifiable group or individual who can affect the achievement of an organisation's objectives, or who is affected by the achievement of an organisation's objectives" (Freeman and Reed, 1983, p. 91). Therefore, stakeholders of any business could pressure firms to embrace practices that ensure transparency and accountability. In relation to this study, the various stakeholders of banks will wield power on the reporting practices in order to reduce the extent of information asymmetry. Since there is usually a high level of opacity in the banking sector, strong adherence to reporting and auditing standards is a way that stakeholders could assure themselves of high level of transparency and accountability in bank's reporting practices.

Empirical Literature Review and Hypotheses Development

As the world's economy has become interconnected due to the move towards globalization, economies are putting in efforts to adopt a harmonized set of accounting and reporting standards. The international Accounting Standards Board's international financial reporting standards (IFRS) have been adopted by many countries including that of SSA. The IFRS are the principles and guidelines that underpin the preparation and presentation of financial statements. The benefits of the adoption of IFRS reporting have been a matter of controversy accounting practitioners and among academics.

Some argue that the disclosure requirements of the IFRS, when applied, improves the quality, comparability, transparency and decision usefulness of financial information (Toumeh & Yahya , 2019). The underpinning philosophy of this school of thought is that IFRS reporting lessens the amount of management judgement and discretion, thereby pushing managers to report the factual and underlying financial condition of firms and eventually reducing discretionary accruals (Gray, Kang, Lin, & Tang, 2015). Consistent with this, the adoption of IFRS globally could remove the barriers and differences in local accounting standards, facilitates cross-border investment, improve the liquidity of international capital markets and reduce cost of capital (Chen & Zang, 2010; Covrig Defond & Hung, 2007; Merton, 1987).

Earnings management has been described by Healy and Wahlen (1999, p.368) as "earnings management 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". Davidson et al. (1987, p. 17) provides a more comprehensive definition as "the process of taking deliberate steps within the constraints of generally accepted accounting principles to bring about a desired level of published earnings". The aforementioned definitions provide some cues that once managers' actions aimed at obtaining and disclosing desirable earnings to stakeholders are within the confines of accounting standards, mere adoption of the standards may not necessarily prevent or reduce earnings management practices (Toumeh & Yahya, 2019).

Some studies had earlier highlighted that the principle-based nature of accounting standards are allows for the discretion in professional judgement as well as the preparation and presentation of financial information to stakeholders (Jeanjean & Stolowy, 2008). The use of judgement by managers has been identified in the estimation of expected useful life of non-current assets, the selection of depreciation methods and valuation methods, working capital management, and other policies that affect the value of earnings declared (Toumeh & Sofri , 2019). Managers may take advantage of this flexibility to manipulate earnings by selecting accounting principles and making estimates that hide the true economic situation with the aim of reporting desirable's earnings to stakeholders (Gray, Kang, Lin, & Tang , 2015).

Earnings management in the context of banks differs from non-financial institutions in terms of banks' reporting structure (Mangala & Singla, 2021), business structure (De Andres & Vallelado, 2008), level of information asymmetry (Leventis et al., 2013) and opacity (Morgan, 2002). This is due to the risky nature of operations in the banking industry and the role information plays in reducing bank runs. By managing earnings, a bank can reduce customers' negative perception of its stability and eventually avoid bank runs (*see* Taylor, Awuye & Cudjoe, 2023). Beyond the bank themselves, earnings management could be very vital to the banking industry as failure of a systemically important bank could spread to other banks and cause financial crisis.

Despite the growing volume of studies on IFRS adoption and earnings management, only a limited number of research have considered the extent of

compliance to these standards. Leuz et al. (2003) argued that the extent and the efficacy of accounting standards in reducing discretionary accruals and earnings management practices depends on how well they are enforced. Despite this, to the best of our knowledge, no study examines how the extent of compliance to accounting standards influence earnings management of banks. Some prior studies have shown that as the adoption of IFRS attempts to harmonize the preparation and presentation of financial information, the extent of use of professional judgement could be influenced by culture and other institutional and locational factors (Eiler, Miranda-Lopez, & Tama-Sweet, 2022).

In this regard, this study argues that locational factors such as strong auditing standards may be required to complement accounting standards to reduce the extent of managerial discretion. Auditors play an important role in the provision of useful and credible financial information to stakeholders. They act as independent intermediaries between stakeholders and managers to provide assurance about the quality of accounting information and the adherence to accounting standards. As managers attempt to use their discretion to provide desirable earnings to stakeholders, auditors inspect to reduce the level of managerial discretion and bias. Auditors are mandated by auditing standards to confirm the quality and acceptableness of accounting information (Alzoubi, 2016). Thus, audit quality is expected to curb the opportunistic behavior of managers and reduce information asymmetry. Soderstrom and Sun (2007) therefore find that the quality of earnings can improve when investors monitor the activities of managers through external auditors.

Apart from the role played by external auditors, extant literature have investigated the role played by internal mechanisms such as audit committees and internal audit on earnings management. Similar to external audits, audit committees and internal audits have been identified to minimize earnings management and enhance firm accountability. Internal audits and audit committees are constituted to reduce the effects of the agency problem through the monitoring of management behaviour to protect the investments made by stakeholders. Altogether, auditing standards could make internal and external audit functions effective in reducing earnings management. If auditing standards complements accounting standards to minimise the extent of information asymmetry and managerial discretion, then high level of compliance to ARs could reduce a substantial amount of earnings management. From the discussions above, the study hypothesises that:

H1: Generally, banks in economies with strong auditing and reporting standards are less likely to practice high level of earnings management.

One of the compelling findings by earnings management literature is that legal origin has a significant effect on the practice of earnings management. This can be adduced to the fact that different legal origins have different accounting and reporting practices which contributes to the difference in the quality of financial information produced (Oz & Yelkenci, 2018). Leuz et al. (2003) argued that the extent and the efficacy of accounting standards in reducing discretionary accruals and earnings management practices depends on the how well they are enforced. The enforcement of accounting standards will also depend on the legal regime of that jurisdiction. Prior studies have examined the relationship between legal origin and earnings management

behavior by examining the level of investor protection (*see* Leuz et al., 2001; Nabar & Boonlert-U-Thai, 2007; Boonlert-U-Thai et al., 2006), accounting tradition (see Oz & Yelkenci, 2018; Ball et al., 2008) and institutional and political influence on the implementation of accounting standards.

Chin et al. (2013) finds that common law countries offer investors the best protection which limits the ability of firms to manage earnings. Further, Ball et al. (2008) reiterates that common law systems are more conservative and provides a timely recognition of losses. Also, common law countries favour public disclosure of financial information thus there is little or no information asymmetry between the shareholder and the manager (Istiqomah, 2018). However, in the context of banks, Shen and Chih (2005) observes that banks occupy a strategic position to the entire financial system and thus allow some level of opacity to prevent bank runs and other levels of systemic risk. Civil law countries on the other hand, is characterized by a small group of agents who act for intermediaries such as labour unions, banks and pension plans, with private and "inside" access to information (Ball, Robin & Wu, 2000). As a result, there is reduced demand for public disclosure of information thus reducing the timely recognition of value-relevant information in reported earnings. Thus, consistent with Ball et al. (2000), the study argue that civil law accounting practices give more space for income smoothing by decreasing earnings in bad years and reversing these adjustments in good years to increase earnings. The research predict that earnings management will be more prevalent in civil law countries.

Despite the relevance of ARs in reducing the extent of earnings management, its efficacy could be underpinned by the legal framework within

which these standards operate. d'Arcy (2000) found that economies with Anglo-American legal origin strictly enforces explicit accounting rules than other economies. Subsequently, La Porta et al. (2002) contended that economies with common law origin provides investors a high level of protection due to their relatively efficient enforcement mechanisms compared to countries with civil law origin. More recently, studies (Adela et al., 2022) show that the legal origin of an economy could strengthen or weaken the robustness of ARs. Thus, if the implementation of standards that govern accounting practices differs across economies with different institutional structures (Jeanjean & Stolowy, 2008), then the legal origin of an economy could influence the relationship between SARS and earnings management. Therefore, the study state the following hypothesis:

H2: Legal origin significantly moderates the relationship between SARs and earning management of banks in sub-Saharan African economies.

Research Methodology

Data

The study obtains bank level data from bankscope data base. The study period was restricted to 2007 as the commencing year due to data availability on all key variables of interest. The study also collected country level SARs data from the Global Competitiveness Index Dataset. The study then merges the two data sets, to obtain a sample of bank level and country level observations that spans 2007 – 2021. The study also controls for some banking sector variables by obtaining country-level data from the global financial development data base. Finally, the study also controls for some macroeconomic indicators by obtaining data from the world development

indicator dataset. Finally, we then clean the data by dropping bank-year observations that has missing data on earnings management and the variables employed to compute earnings management.

Measure of Earnings Management in the Banking Industry

Banking literature have primarily focused on employing loan loss provision as a measure of earnings management due to several reasons. First, compared to other forms of accruals, this accrual has a higher magnitude, and it is significantly correlated with total accruals (Beatty & Liao, 2014). Second, since bank managers compute loan loss provisions to depict the losses that they expect on a present loan portfolio, the inherent discretionary part allows them to engage in earnings management. Also, managers are incentivized to employ loan loss provision as an earnings management tool since its large magnitude sends signals about the bank's financial health (Greenawalt & Sinkey, 1988). Thus, extant literature on bank's earnings management literature have employed loan loss provision as a measure of earnings management.

Total LLP may however, not truly reflect the earnings management incentives of banks, and thus Liu and Ryan (2006) advise the use of the discretionary component of LLP as an earnings management measure. The argument here is that the mandatory or prescribed loan loss provision does not leave room for managerial opportunism, but the discretionary component does. In line with this, the study follows Fan et al. (2019), Beatty and Liao (2014) and employs the discretionary component of LLP as the main proxy for the degree of earnings management, using the following steps. The study estimates the key determinants of LLP using fixed effect estimator. To prevent

scaling problem and impact of size on the regression results, which could possibly weaken the explanatory power of the regressors (*see* Taylor et al., 2023), we follow extant literature (*like* Balboa, López-Espinosa, & Rubia, 2013; Taylor et al., 2023) and scale the bank level variables by total assets. Next, the current research predicts the error term like Cornett et al. (2009). Based on the argument of Beatty et al. (2002), the research removes the potential effect of outliers on the error term by winsorising the data at 1% and 99%, based on the criterion employed by Taylor, Awuye and Cudjoe (2023). The basic regression equation is specified as:

$$LLP_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_1 \Delta LOAN_{it} + \beta_2 LCO_{it} + \beta_3 LLA_{it-1} + \beta_4 \Delta NPL_{it-2} + \beta_6 \Delta NPL_{it-1} + \beta_7 \Delta NPL_{it} + \beta_8 NPL_{it+1} + \varepsilon_{it}$$

Where LLP represents Loan loss provision, size is the natural log of total assets, $\Delta LOAN$ represents the difference between the total loans in the current period and one year lag, LCO represents net loan charge offs, LLA represents Loan Loss Allowance and ΔNPL_{it-2} represents difference between the non-performing loans in 2-year lag and 3-year lag, ΔNPL_{it-1} represents the difference between the non-performing loans in 1-year lag and 2-year lag, ΔNPL_{it} represents the difference between the non-performing loans in the current period and 1-year lag, and 2-year lag, NPL_{it+1} difference between the non-performing loans in year t+1 and t, and $\varepsilon$is the error term. The error term is regarded as the discretionary part of the loan loss provision.

Model Specification and Estimation Strategy

The study employs dynamic panel model to estimate the relationship between SARs and bank earnings management with two specifications. First, the study specifies a linear regression model to estimate the direct

relationships between SARs and banks earnings management in Equation (2). In equation (3), equation (2) is modified to include an interaction term between SARs and legal origin to test the moderating effect of legal origin on the relationship between SARs and banks earrings management as follows:

$$DLLP_{it} = \beta_0 + \beta_1 DLLP_{it-1} + \beta_2 SARs_{it} + \beta_3 LO_{it} + \beta_i X_{it} + \beta_3 Y_{it} + \beta_4 Z_{it} + \varepsilon_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

Where DLLP, discretionary loan loss provision estimated from equation (1).

$$DLLP_{it} = \beta_0 + \beta_1 DLLP_{it-1} + \beta_2 SARs_{it} + \beta_3 LO_{it} + \beta_4 (SARs * LO)_{it} + \beta_i X_{it} + \beta_i Y_{it} + \beta_i Z_{it} + \varepsilon_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

The main regressors of interest are strength of auditing and reporting standards (SARs) and legal origin (LO). X represents a set of bank level control variables; Y represents a set of banking sector control variables and Z represents a set of macroeconomic control variables. The details of the variables and measurement are in Table 1. We follow Balboa et al. (2013) and Taylor et al. (2023) and scale the bank level control variables by total assets to avoid scaling issues.

The study control for three sets of variables, covering bank characteristics, banking sector characteristics and the macroeconomic environment. Following Fan et al. (2019), the study does not control for bank level variables that were employed in estimating the discretionary LLP. If the intention of manager who increase the discretionary component of LLP is to manage earnings, earnings before tax could influence the extent to which managers create DLLP. In line with existing literature (Anandarajan et al., 2007), the study however controls for earnings before tax. Banks are likely to face penalties when they are unable

to keep up with the required regulatory capital (Leventis et al., 2011). Following Elnahass, Izzeldin and Steele (2018), the study controls for the lag of capital adequacy ratio since capital adequacy in period t−1 is likely to influence the extent of earnings management in the next period. The study also controls for bank's fees and commission because banks that are characterized by large fees and commission tend to increase their DLLP to signal that the bank is well-diversified and safe, with interest in non-traditional bank activities (*see* Hasan & Hunters, 1999). With respect to the banking sector characteristics, the study control for banking sector competition. A high level of banking sector competition could incentivize banks to engage in earnings management to survive (*see* Chang, Liang & Yu, 2019). Thus, banking sector competition can influence earnings management. To control for how the overall economic conditions influence bank earnings management, the study follow Leventis Dimitropoulos, Anandarajan, (2011) and control for GDP.

Table 1: Variables and Measurement

Variable Name	Indicator	Measurement
Earnings management of Banks measure: Discretionary Loan Loss Provision	DLLP	The calculation had already been discussed. High value shows high level of bank earnings management.
Strength of auditing and reporting standards	SARS	"Measured on a scale of 1 – 7. 1 = extremely weak; 7 = extremely strong"
Legal origin	LO	"Dummy Variable. 1 for common law origin and 0 for civil law origin"
Earnings before tax	EBT	"Bank earnings before tax and loan loss provisions"
Capital adequacy ratio	CAR	"Bank capital divided by its risk-weighted assets"
Fees and commission income	FCOM	Income generated by bank on non-traditional activities
Banking sector concentration	BCON	"Banking sector Assets of three largest commercial banks as a share of total commercial banking assets. Economic theory suggests that a high level of concentration reduces competition and thus represent an inverse measure of competition"
Gross Domestic Product.	GDP	Gross Domestic Product at constant US 2015.

Source: Author's construct (2023).

Estimation Technique

The use of dummy variable as a regressor as well as the unobservable cross-sectional effects in such panel models necessitate the use of fixed effect estimator. This is because the omission of the unobservable cross-sectional effects could lead to some spurious correlations (Arioglu, 2020). Therefore, the fixed effect of the banks as well as the countries need to be controlled for. Besides the problem of omitted variable bias, it is likely that there could reverse causality between the dependent variable and the regressors. For instance, earnings management practices of banks can affect incentives of regulators to strengthen auditing and reporting standards. This can cause reverse causality issues.

Also, DLLP in previous period is related to current period because the adjustment of LLP to account for losses may be gradual corollary to default (Bouvatier & Lepetit, 2008). Employing the lag of the dependent variable as a regressor as well as the reverse causality issues could lead to potential endogeneity problems in the regression estimates. In such a situation, static model estimators like fixed effects estimators will not be appropriate. Arellano and Bond thus recommend the use of the General Method of Moment (GMM) estimator in such as case. Specifically, the study employs the two-step system general methods of moments (SGMM), which has been theoretically argued to produce highly performing and consistent estimates (*see* Abeka et al., 2022).

To assess the adequacy of the SGMM estimates, the study employs AR (1) and AR (2) to test for serial correlation in the first and second order. The null hypothesis of the autocorrelation tests is that there is no serial or autocorrelation. Most importantly, for the SGMM estimates to be adequate,

the null hypothesis of the autocorrelation test in the second order should not be rejected. In addition, another key diagnostic is the Hansen test of instrument exogeneity and validity. It is expected that the null hypothesis of the Hansen test is rejected to show that the instruments employed in the SGMM estimations are strictly exogeneous and valid.

Empirical Results and Discussion

Univariate Statistics

In Table 2, the study presents the descriptive statistics of the variables employed in the correlation and regression analysis.

Table 2: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
DLLP	547	.009	.02	-.048	.078
SARS	547	4.221	.834	2.134	6.727
LO	547	.616	.486	0	1
EBT	547	57802.081	204683.71	-1870464.9	2213290.2
CAR	547	23.212	23.272	-214.8	262
F COM	547	57316.9	237827.31	0	2291807.6
BCONC	547	64.411	18.915	29.11	100
GDP	547	5.908e+10	1.090e+11	7.481e+08	5.094e+11

Note: DLLP represents discretionary loan loss provision, SARS represents strength of auditing and reporting standards, LO represents legal origin, EBT represents earnings before tax, CAR represent capital adequacy ratio, FCOM represents fees and commission income, BCON represents banking sector concentration. GDP represents Gross Domestic Product. The descriptive statistics of the variables are presented in their non-transformed form.
Source: Field survey (2023)

Table 2 reports the descriptive statistics for common samples of the variables. On average, the SARS in the sampled economies seems to be a little above average in the sampled SSA economies and this is in line with the findings of Adela et al. (2022). Also, average of the legal origin variables shows that majority of the sampled SSA economies are characterized by common law legal origin. The earnings before tax, and fees and commission income variables depict huge variability. Therefore, they were scaled by Total assets and winsorised at 1% and 99% before employed in the correlation and

regression analysis. To reduce the amount of variance in capital adequacy ratio and GDP, the study employs their natural logarithm form in the correlation and regression analysis.

Bivariate Analysis

The pairwise correlation on the variables are presented in Table 3. As expected, the lagged DLLP exhibits a strong positive correlation (0.947) with DLLP, showing the persistence of DLLP and supports the argument for the use of SGMM.

Table 3: Correlation matrix

Variables	DLLP	L.DLLP	SARS	LO	EBT_TA	F_COM_TA	L.CAR	lnBCON	lnGDP	VIF
DLLP	1.000									
L.DLLP	0.947***	1.000								2.52
SARS	-0.272***	-0.312***	1.000							1.76
LO	-0.139***	-0.139***	0.522***	1.000						1.57
EBT_TA	-0.129***	-0.084**	-0.022	0.084***	1.000					1.33
F_COM_TA	0.161***	0.139***	-0.029	0.045**	0.124***	1.000				1.33
L.CAR	0.209***	0.207***	-0.089***	0.001	-0.015	0.039	1.000			1.35
InBCON	-0.057	0.069*	-0.133***	-0.343***	-0.041**	0.143***	-0.046*	1.000		2.03
lnGDP	-0.612***	-0.609***	0.152***	0.257***	-0.009	-0.063***	-0.055**	-0.452***	1.000	2.76

Note: **** p<0.01, ** p<0.05, * p<0.1.* DLLP represents discretionary loan loss provision, L.DLLP represents the lag of discretionary loan loss provision, SARS represents strength of auditing and reporting standards, LO represents legal origin, EBT_TA represents earnings before tax scaled by total assets, L.CAR represent the lag of capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, InBCON represents the natural log of banking sector concentration. InGDP represents the natural log of Gross Domestic Product.
Source: Field survey (2023)

Table 3 presents the results on the bivariate relationship among the variables. This study observes a high level of correlation (greater than 0.80) between the DLLP and its lag, justifying the use of SGMM because of variable persistence (*see* Lo, 2004). Consistent with the argument of Hasan and Hunter's (1999), the study finds a positive relationship between DLLP and Commission and fees income. Also, the study finds SARS, legal origin, earnings before tax and loan loss provision to be negatively related to DLLP. This provides some cue that they could reduce the level of earnings management of banks. Since the VIF values of the regressors are less than 5, the study contend that the model does not suffer from multicollinearity problems, in line with Hair et al. (1995).

Regression Results

Table 4 starts by examining how SARS standards and legal origin is related to earnings management of banks in column one. Next, the results on the role of legal origin in the relationship between SARS and earnings management of banks in presented in Column (2). The diagnostics in all the regression results show that the results are reasonable. Specifically, the p-value of the ARS statistic revealed that no autocorrelation was observed in the second order. Further, the p-value of the Hansen J-tests shows that the instruments employed were exogenous. Finally, a comparison of the number of groups vis-à-vis the number of observations shows that the estimates do not suffer from instrument proliferation.

Table 4: Regression results on the effect of SARS and LO on earnings management of banks in SSA economies

	(1)	(2)
l.DLLP	0.9136***	0.8853***
	(0. 0582)	(0.0598)
SARS	-0.0399***	-0.0607***
	(0.0056)	(0.0109)
LO	-0.0703**	-0.0170
	(0.03361)	(0.0347)
SARS*LO		-0.0622***
		(0.0107)
EBT_TA	-0.265***	-0.245***
	(0.0613)	(0.0608)
F_COM_TA	0.275***	0.271***
	(0.0747)	(0.0819)
L.CAR	0.0194	0.0115
	(0.0210)	(0.0216)
lnBCON	-0.0265***	-0.0262***
	(0.00424)	(0.00502)
lnGDP	-0.0154***	-0.0154***
	(0.000842)	(0.00102)
Constant	0.496***	0.470***
	(0.0243)	(0.0600)
Observations	408	408
No. of groups	123	123
No. of instruments	42	42
AR1 (p-value)	0.533	0.460
AR2 (p-value)	0.467	0.590
Hansen-J (p-value)	0.376	0.382

Note: Standard errors in parentheses * p<0.10, ** p<0.05, *** p<0.010. Dependent Variable: DLLP, DLLP represents discretionary loan loss provision, l. DLLP represents the lag of discretionary loan loss provision, SARS represents strength of auditing and reporting standards, LO represents legal origin, EBT_TA represents earnings before tax scaled by total assets, l. CAR represent the lag of capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnBCON represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.
Source: Field survey (2023)

Like Bouvatier and Lepetit (2008), the lag of DLLP in both columns of Table 4 is significantly related to DLLP in the current period. The significant negative coefficients of SARS in columns (1) and (2) of Table 4 suggests that SARS is negatively related to earnings management of banks. These findings suggest that in an economy where there is compliance to auditing and reporting standards, earnings management behaviour of bank managers is likely to be minimized. In line with the argument of Leuz et al. (2003), our

findings suggest that the extent and the efficacy of accounting standards in reducing earnings management practices depends on the how well they are enforced. The results also emphasise the critical role of auditing standards compliance as a complement to accounting standards in reducing the extent of managerial discretion of banks in SSA. Also, our results support the argument that banks consist of a nexus of contracts and therefore compliance to a set of accounting and auditing standards will increase comparability and pressure managers to minimize earnings management. Thus, this study's results support the arguments of Jeanjean and Stolowy (2008).

In both columns of Table 4, legal origin of an economy exhibits inverse relationship with earnings management. Based on the measurement of legal origin, the results indicate that banks in economies with common law legal origin exhibits lower level of earnings management as compared to banks in economies with civil law origin. The enforcement of accounting and auditing standards could depend on the efficacy on the legal background of an economy and thus difference in the legal framework of economies (*see* Jeanjean & Stolowy, 2008). Thus, in line with the contention of La Porta et al. (2002) that civil law economies are characterised by have weaker protection as compared to common law countries, evidence suggest that the strict rules enforcement regime nature of common law countries limits the extent of managerial discretion. This is consistent with d'Arcy (2000) who finds that firms in economies with Anglo-American legal framework have low incidences of earnings management behaviour and high-quality financial reports.

The results in column (2) include an interaction term of SARS and legal

origin and presented in column 2 of Table 4. The introduction term of the interaction causes the coefficient of SARS to reduce and the coefficient of the interaction term itself is negative and significant. This means that the negative effect of SARS is more pronounced with the interaction term, which supports that SARS the negative effect of SARS on earnings management is stronger in SSA economies with common law legal origin as compared to economies with civil law legal origin. In line with La Porta et al. (2002), SARS is likely to be more effective in common-law legal origin economies than civil law countries. The results of this study corroborate that of Adela et al. (2022) who find that common law countries in SSA have a stronger auditing and reporting standards as compared to civil law economies.

For the control variables, earnings before tax, banking sector concentration and GDP exhibit a negative relationship with earnings management of banks. This evidence shows that when banks make a higher level of earnings before tax and loan loss provision, they are less likely to engage in earnings management because of the existing high earnings. This corroborates the findings of Taylor et al. (2023). Since high level of concentration signifies a less competitive banking sector, the negative coefficient of banking sector concentration could be that low level of competition do not incentivize banks to manage earnings but rather a high level of banking sector competition may incentivize banks to manage earnings in the quest to survive. The result on GDP suggests that banks are less likely to manage earnings in periods of economic prosperity. The positive coefficient of fees and commissions income shows that banks that are characterized by large fees and commission tend to increase their DLLP to signal that the bank is

well-diversified and safe, with interest in non-traditional bank activities (*see* Hasan & Hunters, 1999).

Robustness Check

A robustness check is conducted using an alternative measure of earnings management. The study adopts a different approach to identify how SARS influences earnings management behaviour of banks using the SGMM estimator. Although a preliminary static model analysis favours the use of fixed effect estimator over random effect estimator, the study did not employ the fixed effect estimator due to the dynamic nature of the model and the inclusion of a relevant dummy variable like legal origin. Some key papers on earnings management suggests that there is evidence of earnings management through income smoothing when EBT is positively related to earnings management (Taylor et al., 2023; Anandarajan Hasan, & McCarthy, 2007; Ahmed, Takeda, & Thomas, 1999).

Following these studies, the study estimates the SGMM results with LLP as the dependent variable and EBT as the main regressor along with the variables that we control for and present the results in model 1 in Table 5. The report omitted SARS and LO from the results in column 1 of Table 5 to detect the level of earnings management in their absence. Next, the research includes SARS in the estimation and present the results in column 2 to examine the possible change in the EBT coefficient with the inclusion of SARS. Finally, the study then includes SARS and LO in the estimation and present the results in column 3. The coefficient of EBT in column 1 of Table 5 is the highest, next is the coefficient in column 2 and finally column 3. The results show the invaluable role of SARS and earnings management in reducing earnings

management behaviour of banks. Overall, the results reported in Table 5 suggest that the initial findings in Table 4 are robust to alternative measures of earnings management.

Table 5: Robustness check on the regression results on the effect of SARS and LO earnings management of banks in SSA economies

	(1)	(2)	(3)
L.LLP_TA	0.8129**	0.8419**	0.8300***
	(0.3485)	(0.3656)	(0.2481)
EBT_TA	0.244***	0.210***	0.208***
	(0.0654)	(0.0594)	(0.0594)
LOAN_TA	0.0181**	0.0232***	0.0191*
	(0.00825)	(0.00836)	(0.00977)
LLA_TA	0.182***	0.144***	0.138***
	(0.0504)	(0.0504)	(0.0503)
F_COM_TA	0.159**	0.133*	0.129*
	(0.0706)	(0.0719)	(0.0714)
LCO_TA	0.076	0.0712	0.0923
	(0.0821)	(0.0912)	(0.0822)
SIZE	0.0103	0.0870	0.0670
	(0.0107)	(0.0932)	(0.0955)
lnBCON	-0.0127***	-0.0121***	-0.0118***
	(0.00446)	(0.00421)	(0.00422)
lnGDP	-0.0190	-0.0158	-0.0134
	(0.0151)	(0.0134)	(0.0137)
SARS		-0.0202***	-0.0582***
		(0.0044)	(0.0023)
LO			-0.0392**
			(0.0191)
Constant	0.0824**	0.0803**	0.0751**
	(0.0370)	(0.0360)	(0.0364)
No. of instruments	47	47	47
AR1 (p-value)	0.00383	0.000996	0.00112
AR2 (p-value)	0.551	0.758	0.805
Hansen-J (p-value)	0.148	0.156	0.140

Note: Standard errors in parentheses * p<0.10, ** p<0.05, *** p<0.010. Dependent Variable: LLP, DLLP represents discretionary loan loss provision, L.DLLP represents the lag of discretionary loan loss provision, SARS represents strength of auditing and reporting standards, LO represents legal origin, EBT_TA represents earnings before tax scaled by total assets, LCO_TA represents net loan charge offs scaled by Total Assets, LOAN_TA represents gross loan scaled by Total Assets, LLA_TA represents loan loss allowance scaled by total assets, L.CAR represent the lag of capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, InBCON represents the natural log of banking sector concentration. InGDP represents the natural log of Gross Domestic Product.
Source: Field survey (2023)

Summary and Conclusions

Auditing and reporting standards represent important institutional factors that are important to limiting opportunistic behaviour of management and are therefore expected to reduce earnings management of banks. The impact of robust auditing and reporting requirements on bank profits management in SSA was revealed by this study. The study also investigated the possibility that the association between SARS and bank earning management may be mitigated by accounting tradition, as determined by legal origin. This is the first research to look at how banks' level of earnings management may change if they comply with Auditing and Reporting criteria. Amidu and Issahaku's (2019) study, among others, focused solely on the impact of IFRS adoption—rather than compliance—on the earnings management of African banks.

According to SGMM predictions, SSA banks' profits management practices will decline as auditing and reporting are strengthened. Additionally, the data demonstrate that in nations with a common law accounting past as opposed to a civil law one, there is a higher negative correlation between SARS and profits management. This demonstrates how important it is to have a better accounting tradition in order to lessen earnings management behaviour. This affects SSA banks that have not yet embraced or committed to following IFRS and IAS, as well as the region's economy.

It would provide benefits such as reduction in the opportunistic outcomes of earnings management, reduce information asymmetry and improve bank performance. From the study findings, this recommendation is much more important to economies that have civil law legal origin as they are

usually characterized by weaker protective accounting frameworks. These recommendations could also be beneficial to banking sector regulators that require transparent and accurate information to aid in their monitoring duties. Finally, the recommendations are also important to bank that wish to reduce the extent of information asymmetry between bank managers and stakeholders in order to boost stakeholder confidence and improve bank performance.

CHAPTER FIVE

CONTRACTING INSTITUTIONS, POLITICAL INSTITUTIONS AND EARNINGS MANAGEMENT OF BANKS IN SUB-SAHARAN AFRICA

Abstract

This empirical chapter looks at the link between political institutions and contractual institutions' impact on banks' earnings management. This chapter makes use of panel data that includes accessible bank- and country-level observations from 2007 to 2021. The models were estimated in this chapter using the System Generalized Method of Moments (SGMM). The results of the SGMM estimations imply that the majority of contracting institutions have a detrimental impact on the bank's management of earnings. When political institutions regulate the relationship, the outcome is more profound. This finding is pertinent to emerging markets that aim to curtail the degree of earnings manipulation practices in the banking industry. For such attempts to be successful, their political and contractual institutions must be strengthened.

Introduction

A preponderance of cross-country studies on earnings management have dedicated considerable attention to explaining differences in institutional settings as a major determinant of earnings management (*see* Zhanga, Uchidab & Dong, 2020). Despite Jensen and Meckling (1970)'s argument that firms consist of a nexus of contracts; the burgeoning literature have not distinguished the role of "contracting institutions" in reducing the extent of earnings management. Acemoglu et al. (2003) highlight the important role of contracting institutions in economic transactions by arguing that, contracting institutions represent mechanisms that ensure enforcement of contracts

between two parties. In our view, contracting institutions will be much more important to earnings management of banks since because banks are different from non-financial firms in terms of their nexus of contracts.

The core operations of a bank involve accepting deposits and issuing loans. Thus, the loan and deposit contracts between the bank and its customers are fundamental to the existence and continuity of bank operations. Based on risk and return theory, banks may issue loans to "bad borrowers" to increase their interest income. However, to avoid bank runs in such instances, bank managers could employ earnings management to send a positive signal to depositors. By reporting a lower amount of loan loss provision (LLP), bank managers can send a good signal about their loan recovery rate and depositors may be assured of the security of their deposits. Despite this benefit, such reported LLP may not reflect the economic reality of the bank. Due to the complex features of bank risk and how it develops and changes, healthy competition and strong institutional setting are both necessary to deal with factors associated with bank risk (Taskinsoy, 2020).

It has been well-documented that firms in economies with weak institutional setting are highly susceptible to information opacity while firms in economies with strong institutional setting are not (*see* Anand & Green, 2012). Based on the premise that LLP information influence the perceptions of market participants of bank's liquidity, bank managers should have incentives to manage earnings to improve their stability. Contracts between depositors and banks to some extents are accounting information based, and thus banks are likely to manage earnings to avoid paying large interest on deposits (Tran & Ashraf, 2018). However, if there were contract enforcement mechanisms

among the several contracting parties of a bank, the bank itself is likely not to engage in information asymmetry behaviours. The forgoing view arguments naturally leads to the prediction that contracting institutions could reduce the extent of earnings management behaviours of banks.

In examining the relationship between contracting institutions and earnings management of banks, this study follows the arguments of Jensen and Meckling (1976) and Acemoglu and Johnson (2005) to employ five main proxies for contracting institutions, i.e., creditor right protection, cost of enforcing contracts, number of contract enforcement procedures, judicial independence and reliability of police. There are several reasons to suspect that these variables show the extent to which contracts between private parties could be enforced. For instance, the powers given to police by the state can ensure contract performance and enforce damages collection in the case of non-performance. Courts are usually charged with the duty of adjudicating conflicts among contracting parties and therefore judicial independence is very vital to contract enforcement.

Similarly, trust and certainty are built when there are less costly contract enforcement procedures (Sheng, Zhou, Li, & Guo, 2018). If there is a large number of legal procedures required to enforce contracts, the efficacy of the judicial structures will be weakened, causing unnecessary court hearing delays and eventually increasing the cost of enforcing contractual rights. In all, contracting institutions ensures the sanctity of contract and determines the extent to which business contracts among private parties are useful, viable, productive and profitable. Despite the possible relevance of these contracting

institutions to earnings management, extant research has mainly focused on implications of these institutions to economic growth.

Our observation therefore is that empirical works on contracting institutions and earnings management of banks in emerging economies such as that of SSA is quite rare and there is no impeccable evidence. With minute or no research conducted on the relationship between contracting institutions and earnings management of banks in SSA, this study is motivated to empirically examine the relationship between contracting institutions and earnings management of banks in SSA. In particular, this study examines five related hypotheses, that is, the influence of each of the contacting institutions on earnings management of banks in Africa.

Apart from providing an understanding on how contracting institutions affect earnings management of banks, this study enhances of our knowledge of the conditions under which the relationship can be altered. Generally, strong political institutions can strengthen the ability of stakeholders to monitor the activities of bank executives, reduce information asymmetry (Haris et al., 2019) and possibly reduce the extent of earnings management. Thus, this study looks at how political institutions may have an impact on the link between contracting institutions and bank profits management. The Hierarchy of Institutions Theory, which is supported by Magnin (2018), states that the effectiveness of certain institutional structures depends on the effectiveness of other institutional structures. A central question answered by this study is whether the relationship between contracting institutions and earnings management of banks is affected by political institutions.

In that regard, this study makes three key contributions. By examining the relationship between contracting institutions and earnings management of banks, this study makes a unique contribution because extant literature does not analyse the effect of a cluster of contracting institutions on earnings management, particularly banks. Theoretical reasons about the relevance of institutional frameworks to financial sector enterprises support the significance of this contribution (*see* La Porta et al., 1997; Beck, Demirgüç-Kunt & Levine, 2003; and Rajan & Zingales,2003).

To the greatest extent of our knowledge, this thesis provides the primary evidence for the SSA context. The banking sector of Africa has some unique features that makes it a particularly interesting context to study. The World Bank data shows that most banks in Africa lacks depth and breath as compared to other continents (*see* Ozili, 2020). Thus, banks are likely to engage in earnings management practices to increase their capital base as well of number of bank accounts held by customers. Another reason for the focus on the banking sector of SSA is that the financial sector of most African countries is bank dominated. Thus, focusing on the banking sector of SSA will provide information that is directly relevant to policy, in terms of strengthening contracting institutions to alter earnings management behaviours of banks. Third, by concentrating on bank earnings management, this study offers sophisticated empirical support for Acemoglu et al. (2005)'s HIH argument, which has received little attention in the financial industry.

Literature Review

The New Institutional theory indicates that economic agents' behaviour is shaped by institutional frameworks at both the macro and micro levels

(North, 1990). Subsequent to North's argument, there has been a growing consensus by economists that the legal, political, economic and social setup of society is a key determinant of economic performance. Despite this, the burgeoning literature does not distinguish between institutions that ensure and support private contracts and institutions that reduce government expropriation (Acemoglu & Johnson, 2005). However, the contracting literature that started with Coase (1937) and Williamson (1985) pointed out the importance of contract enforcement mechanisms as a determinant of economic agents' behaviour. In this regard, this study argues that a cluster of contracting institutions is relevant in determining the extent of earnings management behaviour of bank management. In addition, the study takes cues from the HIH to examine how political institutions determine the efficacy of contracting institutions in reducing earnings management behaviours. The ensuing sub-sections provide a review of empirical literature on the relationships among contracting institutions, political institutions and earnings management of banks.

Contracting Institutions and Earnings Management of Banks

Acemoglu and Johnson (2005) define contracting institutions as "the rules and regulations governing contracting between ordinary citizens, for example, between a creditor and a debtor or a supplier and its customers". Thus, aspects of contracting institutions include creditor right protection, contract enforcement, judicial independence and reliability of the police (*see* Jensen & Meckling, 1976; Acemoglu & Johnson, 2005). This study predicts that in an economy where contract enforcement mechanisms among the several contracting parties of a bank are strong, the bank itself is likely not to

engage in earnings management behaviours. The next sub-sections present a review of literature on each of these contract enforcement mechanisms and earnings management of banks.

Creditor right protection and earnings management of banks

The extent to which creditor rights are safeguarded in an economy is very vital in determining the amount of loans given out to firms, how loans are priced and how loan contracts are enforced. Generally, creditor right protection can alter the incentives of creditors to monitor, enforce loan contracts and to recontract. When creditor rights are strong, creditors usually assure themselves of the repayment of loans and thus may give more credit. It is thus cogent to assume that firms are able to take on more leverage when creditor protection is high. Jensen (1986) argued from the control hypothesis that taking on more debt reduces opportunistic behaviours of managers. This implies that when creditors are able to enforce their rights, managers ability to manipulate earnings could be severely dampened (Wardhani & Anggraenni, 2017). Therefore, Gopalan, Martin and Srinivasan (2022) find that weak creditor rights regimes usually give room to insiders to benefit at the detriment of creditors.

Within the banking domain, the relationship between creditor right protection and earnings management can be explained from two perspectives, the bank as a creditor to loan customers and fixed depositors as creditors to the bank. Ashraf and Zheng (2015) explain that depositors in a strong creditor right regime are more likely to activate clauses to withdraw their fixed deposits in the event of bank managers' expropriation behaviour. In this regard, bank managers may have little or no incentives to manage earnings

because rapid withdrawals could lead to bank runs and eventually put the stability of the bank at risk. Similarly, when creditor rights are strong, banks that lend to firms would have incurred a low level of risk because these banks could enforce seizure of collaterals (Bae & Goyal, 2009). With this, there will be less need for banks to present loan loss provision figures that do not reflect the economic reality of the bank. Therefore, a negative relationship could be observed between creditor right protection and earnings management of banks (Kanagaretnam, Lobo & Wang, 2015). This study hypothesizes that:

H1: Strong creditor right protection has a negative influence on earnings management behaviours of banks

Cost of contract enforcement, contract enforcement procedures and earnings management of banks

Earnings management is more likely to be evident in economies where contract enforcement is weak, cumbersome and costly. Rather, an environment of trust and certainly is created in a less costly contract enforcement environment of certainty and trusts (Sheng, Zhou, Li, & Guo; 2018). High cost of contract enforcement could deter firms' stakeholders from demanding accountability and transparency in firms' reporting practices because the cost of bringing legal actions against management could be less than the benefits. An account of literature shows that managers are less likely to benefit from earnings management if perfect market conditions like costless contract enforcement holds (*see* Habib, Ranasinghe, Wu, Biswas & Ahmad, 2022). Thus, a natural prediction here is that lowering cost of contract enforcement could significantly reduce earnings management behaviours of firms.

Moreover, a high number of contract enforcement procedures such as cumbersome judicial procedures and unnecessary court hearing delays could further derail the enforcement of contractual rights. This can make stakeholders susceptible to managerial expropriations and thus provide room for managers to manage earnings. The peculiar nature of the banking industry makes low number of contracts enforcement procedures particularly important. Banks are faced with a myriad of risks and thus efficient contract enforcement procedures could be vital to reducing earnings management and its associated consequences of bank illiquidity and instability. This study therefore predicts that:

H2a: Lower contract enforcement cost significantly reduces earnings management of banks.

H2b: Lower contract enforcement procedures significantly reduce earnings management of banks

Judicial independence and earnings management

In terms of procedure, the independence of the judiciary is constituted by the impartiality and neutrality of the judges. Sopilnyk and Piwowarski (2021) claim that in order to assess a court's independence, one must take into account a number of variables, including the selection process, the duration of the office, the presence of protections from outside pressure, and outward indications of independence. Making unbiased judgements that are free from outside influence or bias requires a judge to be impartial. A fundamental right to a fair and equitable public hearing, essential to human liberty and economic development, is access to competent, impartial, and independent courts.

Conflicts between contracting parties are resolved by the courts, which also provide precedents that make up the body of common law. The kind of contracts that are executed and the degree to which contracting is relied upon are both impacted by the independence of judiciary. The productivity, usefulness, and viability of different types of organizations are then determined by this (Jensen & Meckling, 1976). Furthermore, court rulings frequently have the ability to affect the rights of contractual parties' ex post (Jensen & Meckling, 1976). Thus, when judicial independence is jeopardized, the ability of the judiciary to prosecute wrongdoing is deteriorated and this results in high levels of corruption and contracting parties' insubordination (Lee-Jones, 2019). In such an environment, bank regulations to ensure transparency in reporting is fatally weakened (Christopoulos, Dokas, Leontidis & Spyromitros, 2022), and bank managers are more likely to alter earning to satisfy their interest at the expense of other stakeholders. With this, another hypothesis is that:

H3: Judicial independence reduces earnings management of banks.

Reliability of police and earnings management of banks

Generally, the belief that earnings management will be difficult to detect is a factor that incentivizes managers to engage in EM behaviours. Thus, the weaker the legal mechanisms that detect earnings management, the more detailed will be the plans that managers put in place to manage earnings (Lo, 2008). This is based on the assumption that the likelihood to committing a crime is a function of the reliability of the policing mechanism put in place to conduct investigations to solve such crimes (Lo, 2008). Jensen and Meckling (1976) gave an earlier exposition by pointing out that the police

have state powers that allows them to ensure contract performance or to ensure the collection of damages due to contract non-performance. Thus, when stakeholders, their lawyers and banking sector regulators detect key differences in financial reports, a reliable policing system can facilitate investigations and possible prosecution when necessary (Ball & Shivakumar, 2008). Another hypothesis formed from the foregoing arguments is that:

H4: A reliable police system reduces the extent of earnings management of banks.

Political Institutions and Earnings Management of Banks

The political cost perspective of the positive accounting theory explains that financial reporting policies and practice of firms can be affected by the politics of wealth distribution by political authorities (Watts & Zimmerman, 1986). On the one hand, in order to avert possible transfer of wealth, firms tend to manage earnings to reduce the reported income (Ben Rejeb Attia, Lassoued & Attia, 2016). On the other hand, firms may disclose accounting information that represents the true and fair view of their economic state as an effort to improve relationships with political authorities. With this, the political setting with which firms exist are likely to alter their incentives to engage in EM. This could manifest in several ways.

First, political authorities have direct influence on the behaviours of economic agents (Piotroski and Wong, 2012; Roe, 1991). Therefore, it is cogent to assume that a political system that is plagued with a culture of poor accountability is likely to accommodate earnings management behaviour of firms. Second, there is evidence that political institutions are strongly associated with other known determinants of earnings management behaviour,

including the level of financial market development (Girma & Shortland, 2008) the efficacy of legal system (Francis, Hasan & Li, 2016), and firm's financial disclosure policies (Francis & Ofori, 2015). Third, the level of uncertainty in the expected cashflows of firms is exacerbated in weak political regimes and therefore could increase information asymmetry between the various stakeholders and the firm. Next, politically connected banks are able to pay lower taxes, operate in a more relaxed regulatory environment, and gain some advantages in competitive bidding for government contracts (Du & Girma, 2010). This means that firms that have political connection are often able to achieve high level of profits and thus may not need to manage earnings. Another school of thought argues that since politically connected firms may be concerned with the political objectives of government, they may rather incur high political costs and then manage earnings to cover up (Wu et al., 2012).

Political stability political rights and earnings management

Lemma, Lulseged, Mlilo and Negash (2020) highlighted the role of political institutions (political stability and political rights) in publicly listed non- financial firms' earnings management behaviour. Political stability could affect the earnings management behaviours of banks because firms usually increase cash holdings due to uncertainties in weak political stability regimes, raising the agency cost associated with free cashflow and eventually incentivise managers to manage earnings (Julio & Yook, 2012). Strong political rights improve transparency in financial transactions and thus lowers earnings management (Trueman & Titman, 1988). This is because when media and other institutions that ensures accountability thrives in strong

political rights regimes, they could serve as a check on bank's activities and limit earnings management behaviour of bank managers. In this regard Lemma et al. (2019) argue that the media can monitor company's activities closely and prevent managerial opportunism.

From the foregoing discussions, two forms of political institutions, that is, political stability and political rights could influence earnings management of banks. It is necessary to offer a sophisticated comprehension of the effect of political institutions on earnings management by focusing on banks. Political institutions that are not strong usually weaken the ability of stakeholders to screen the activities of bank executives, increase information asymmetry (Haris et al., 2019) and possibly increase earnings management behaviour. Conversely, strong political institutions can curb earnings management behaviour. This leads to two hypotheses:

H5a. Strong political stability has a negative effect on earnings management of banks.

H5b. Strong political rights have a negative effect on earnings management of banks.

The interaction effect of political institutions on contracting institutions and earnings management

The hierarchy of institutions hypothesis (HIH) can be used to argue for or against the significance that political institutions play in the interaction between contracting institutions and bank profits management. Acemoglu et al. (2005)'s HIH provides reasons for why the efficacy of some institutional structures depends on some other institutional structures. Magnin (2018) therefore points out that high level institutions tend to dominate lower-level

institutions and therefore affects their efficacy. There are several reasons to assume that a high-level institution like political institution could affect the extent to which contracting institutions are relevant to reducing earnings management behaviour. Political institutions determine the efficacy of regulations and patterns of corporate governance structure in an economy (Lemma et al., 2020; Gourevitch & Shinn, 2005). Also, political rights affect the level and intensity of punishment for management misbehaviour (Francis & Ofori, 2015).

To the extent that political institutions determine the efficacy of regulations and the intensity of punishment for management misbehaviour, it could also affect how mechanisms that ensure enforcement of contracts between two parties reduce earning management of banks. From the HIH perspective, this study attempts to provide answers to some questions on the relationships among contracting institutions, political institutions and earnings management of banks in Africa. For instance, can the fear of creditor right enforcement deter banks from engaging in earnings management when these banks have political connections? Will contract enforcement and judicial independence be strong enough to deter earnings management behaviour when political institutions are weak? Also, to what extent will the police force facilitate investigations and possible prosecution for earnings management behaviour when there is a low level of democracy? To answer these research questions asked, this thesis study hypothesizes that:

H6: Political institutions significantly moderate the relationship between contracting institutions and earnings management of banks.

Research Methods

The study obtained bank level data from bankscope data base. The study period was restricted to 2007 as the commencing year due to data availability on all key variables of interest. The study also collected country level data on contracting institutions from World Doing Business dataset and Global Competitiveness Index Dataset. Political rights data was obtained from freedom house dataset whilst political stability and absence of violence data was obtained from Worldwide Governance Indicator dataset. The study merged these data sets, to obtain a sample of bank level and country level observations that spans 2007 – 2021. The study also controlled for some banking sector variables by obtaining country-level data from the Global Financial Development data base. Finally, the study controlled for some macroeconomic indicators by obtaining data from the World Development Indicators dataset. The study cleaned the data by dropping bank-year observations with missing data on earnings management and the variables employed to compute earnings management.

Measure of Earnings Management in the Banking Industry

Even though a number of bank's earnings management literature have employed loan loss provision as earnings management's measure, it may not truly reflect the true reason for earnings management. Thus, Liu and Ryan (2006) recommend the use of the discretionary component of LLP as an earnings management measure. Therefore, we followed recent bank earnings management literature such as Fan et al. (2019) to construct discretionary loan loss provision and employed that as earnings management's proxy. To construct the DLLP, the following steps were followed. First, a basic

regression equation was specified to estimate the major determinants of LLP using a fixed effect estimator. To deal with scaling problems, we follow the procedure employed by recent bank earnings management literature (*see* Taylor et al., 2023) and scale the bank level variables by total assets. Afterwards, the error term was predicted. Finally, following Beatty et al. (2002), the potential effect of outliers on the error term was removed by winsorising the data at 1% and 99%. The basic regression equation is specified as:

$$LLP_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_1 \Delta LOAN_{it} + \beta_2 LCO_{it} + \beta_3 LLA_{it-1} + \beta_4 \Delta NPL_{it-2} + \beta_6 \Delta NPL_{it-1} + \beta_7 \Delta NPL_{it} + \beta_8 NPL_{it+1} + \varepsilon_{it}$$

Where LLP represents Loan loss provision, size represents bank size as measured by the natural log of total assets, $\Delta LOAN$ represents the difference between the total loans in the current period and 1 year lag, LCO represents net loan charge offs, LLA represents Loan Loss Allowance and ΔNPL_{it-2} represents difference between the non-performing loans in 2-year lag and 3-year lag, ΔNPL_{it-1} represents the difference between the non-performing loans in 1-year lag and 2-year lag, ΔNPL_{it} represents the difference between the non-performing loans in the current period and 1-year lag, and 2-year lag, NPL_{it+1} difference between the non-performing loans in year t+1 and t, and ε is the unexplained component of the regression. The error term is therefore regarded as the discretionary part of the loan loss provision.

Model Specification and Estimation Strategy

The direct impact of political and contracting institutions on bank profits management is depicted in Model 1 below. Then, for us to test investigate the moderating effect of political institutions on the link between

contracting institutions and banks earrings management in model 2, we amended model 1 to add an interaction term between political institutions and contracting institutions :

$$DLLP_{it} = \tau DLLP_{it-1} + \pi CI_{it} + \gamma PI_{it} + \vartheta K_{it} + \psi Y_{it} + Z_i + \varepsilon_{i,t} \ldots\ldots (1)$$

$$DLLP_{it} = \tau DLLP_{it-1} + \pi CI_{it} + \gamma PI_{it} + \upsilon (CI * PI)_{it} + \vartheta K_{it} + \psi Y_{it} + Z_{it} + \varepsilon_{i,t} \ldots\ldots (2)$$

Where DLLP is discretionary loan loss provision is the dependent variable. The main regressors of interest are contracting institutions (CI) and political institutions (PI). K represents a set of bank level control variables; Y represents a set of banking sector control variables and Z represents a set of macroeconomic control variables. The details of the variables and measurement are in Table 1. Again, we follow extant literature (Balboa et al., 2013; Taylor et al., 2023) and scale the bank level control variables by total assets to avoid scaling issues.

Following Fang et al. (2019), this study did not control for bank level variables that were employed in estimation of the discretionary LLP. Like Anandarajan et al. (2007) we control for earnings before tax, the lag of capital adequacy ratio and bank's fees and commission as bank level variables (*see* Elnahass, Izzeldin & Steele, 2018; Hasan & Hunters, 1999). Since a high level of banking sector competition could incentivize banks to engage in earnings management to survive (*see* Chang, Liang & Yu, 2019), we control for banking sector concentration as a banking sector variable. Finally, to control for how changes in overall economic conditions influence bank earnings management, we follow Leventis et al. (2011) and control for GDP.

Measurement of Variables

The details on variables, measurement and data source are presented in Table 6.

Table 6: Variables and Measurement

Variable Name	Measurement	Data Source
Earnings management of Banks measure: Discretionary Loan Loss Provision	The calculation had already been discussed. High value shows high level of bank earnings management.	Bankscope data base
Creditor Rights Protection (CRP)	Getting Credit, Strength of legal rights index. Constructed on a scale of 0 – 100, [0 = no protection and 100 = highest protection]	World doing business database
Cost of Enforcing Contract (CEC)	Cost as a percentage of claims -Score is constructed on a scale of [0 -100] with higher values representing lower costs.	World doing business database
Legal Procedures in Enforcing Contracts (LPEC)	Number of procedures -Score is constructed on a scale of [0 -100] with higher values representing lower number of procedures.	World doing business database
Judicial Independence (JI)	Constructed on a scale of 1 – 7 [7 = Best]	Global Competitiveness Report
Reliability of Police (RoP)	Constructed on a scale of 1 – 7 [7 = Best]	Global Competitiveness Report
Political Stability and Absence of Violence	Constructed of a scale of -2.5 to +2.5	Worldwide governance indicator dataset
Political Rights	Average ratings on the quality of electoral processes, political pluralism and political participation, legislature and executives. This is constructed on a scale of 0 – 40.	Freedom House database
Earnings before tax	Bank earnings before tax and loan loss provisions	Bankscope data base
Capital adequacy ratio	"Bank capital divided by its risk-weighted assets"	Bankscope data base
Fees and commission income	Income generated by bank on non-traditional activities	Bankscope data base
Banking sector concentration	"Banking sector Assets of three largest commercial banks as a share of total commercial banking asset. Economic theory suggests that a high level of concentration reduces competition and thus represent an inverse measure of competition"	Global financial development database
Gross Domestic Product.	Gross Domestic Product at constant US 2015.	Worldwide development indicators database

Estimation Procedure

Estimation procedure usually depends on the nature of relationship among the variables as specified in models 1 and 2. As can be observed from models 1 and 2, DLLP in previous period affects the current period DLLP. This leads to potential endogeneity problems in the regression estimates. As a result, the Two-Step System General Method of Moment (GMM) estimator developed by Arellano and Bond is used in this work. This estimator is appropriate for handling endogeneity issues in situations when the cross-sectional unit's number exceeds that of the time series units. The study uses AR (1) and AR (2) to test for serial correlation in the first and second order in order to evaluate the suitability of the SGMM estimations. The absence of serial or autocorrelation is the null hypothesis of the autocorrelation tests. Above all, the null hypothesis of the autocorrelation test in the second order must not be rejected in order for the SGMM estimates to be sufficient. In addition, another key diagnostic is the Hansen test of instrument exogeneity and validity. It is expected that the null hypothesis of the Hansen test is rejected to show that the instruments employed in the SGMM estimations are strictly exogeneous and valid.

Results and Discussion

Univariate Statistics

In Table 7, the study presents the descriptive statistics of the variables employed in the correlation and regression analysis.

Table 7: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
DLLP	547	.009	.02	-.048	.078
EBT_TA	547	57802.081	204683.71	-1870464.9	2213290.2
CRP	547	50.941	18.152	19	100
CEC	547	48.044	20.167	0	94.276
CEP	547	44.202	14.186	0	83.92
JI	547	3.964	.912	1.286	5.743
ROP	547	3.960	.891	1.271	6.678
PSAV	547	0.542	0.125	-1.654	1.957
PR	547	19.014	10.245	-1.97	39
CAR	547	23.212	23.272	-214.8	262
F_COM_TA	547	57316.9	237827.31	0	2291807.6
BCONC	547	64.411	18.915	29.11	100
GDP	547	5.908e+10	1.090e+11	7.481e+08	5.094e+11

Note: DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, PSAV represents political stability and absence of violence, PR represent political rights, EBT_TA represents earnings before tax scaled by total assets, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, BCON represents banking sector concentration. GDP represents Gross Domestic Product.

Table 7 reports the descriptive statistics for common samples of the variables. The contracting institutions have average ratings close to a median rating of 50. For instance, the average scores of creditor rights protection (CRP), cost of enforcing contract (CEC) and contract enforcement procedures (CEP) is 50.94, 48.044 and 44.202 respectively (on a scale of 100) can be considered average. Similar could be argued for judicial independence and reliability of police (RoP) whose average ratings are 3.964 and 3.960 (on a scale of 7). Political stability and absence of violence reported, and political rights reported averages of 0.542 and 19.014 respectively.

Bivariate Analysis

The pairwise correlation on the variables are presented in Table 8. As expected, the lagged DLLP exhibits a strong positive correlation (0.947) with DLLP, showing the persistence of DLLP and supports the argument for the use of SGMM. The correlation analysis shows that the contracting institutions variables mostly do exhibit a negative relationship with earnings management of banks. Also, political stability exhibits a negative relationship with earnings management whilst political rights exhibit a positive relationship.

Table 8: Correlation matrix

Variables	DLLP	l.DLLP	CRP	CEC	CEP	JI	ROP	PSAV	PR	(EBT_TA)	(F_COM_TA)		(lnBCON)	(lnGDP)
DLLP	1.000													
l.DLLP	0.947***	1.000												
CRP	-0.473***	-0.344***	1.000											
CEC	-0.339***	-0.246***	0.522***	1.000										
CEP	-0.331***	-0.359***	0.116**	0.332**	1.000									
JI	-0.119**	-0.239**	0.114***	0.145***	0.177*	1.000								
ROP	-0.432	-0.437*	0.167	0.336**	0.153*	0.664**	1.0000							
PSAV	-0.657**	-0.612**	0.448**	0.419*	0.235***	0.715**	0.321**	1.000						
PR	0.422*	0.499*	0.190**	0.113**	0.052*	0.235**	0.563***	0.432***	1.000					
EBT_TA	-0.129***	-0.084**	-0.022	0.084***	0.511**	0.155**	0.234***	0.126**	0.334**	1.000				
F_COM_TA	0.161***	0.139***	-0.029	0.045**	0.414**	0.650***	0.441***	0.347***	0.254**	0.124***	1.000			
L.CAR	0.209***	0.207***	-0.089***	0.001	0.346**	0.617***	0.534***	0.315***	0.461**	-0.015	0.039	1.000		
lnBCON	-0.057	0.069*	-0.133***	-0.343***	0.442**	0.645***	0.457***	0.339***	0.487**	-0.041**	0.143***	-0.046*	1.000	
lnGDP	-0.612***	-0.609***	0.152***	0.257***	0.662***	0.676**	0.338***	0.441***	0.313***	-0.009	-0.063***	-0.055**	-0.452***	1.000

**** p<0.01, ** p<0.05, * p<0.1.* DLLP represents discretionary loan loss provision, l.DLLP represents the lag of discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, PSAV represents political stability and absence of violence, PR represent political rights, EBT_TA represents earnings before tax scaled by total assets, l.CAR represent the lag of capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnBCON represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

Multivariate Analysis

Having presented the univariate and bivariate statistics, the thesis proceeds to present the results as well as the empirical discussion of the results. To provide an in-depth insight of how contracting institutions reduce earnings management of banks, the results present the effect of contracting institutions of creditor right protection, cost of contract enforcement (CEC), number of legal procedures in contract enforcement (CEP), judicial independence (JI) and reliability of police (RoP) on earnings management of banks in columns 1, 2, 3, 4 and 5 of Table 9 respectively.

Table 9: Regression results on the relationship between contracting institutions and earnings management of banks in SSSA

	(1)	(2)	(3)	(4)	(5)
L. DLLP	0.696***	0.805***	0.827***	0.877***	0.784***
	(0.0673)	(0.0479)	(0.0478)	(0.0546)	(0.0466)
CRP	-0.129**				
	(0.0601)				
CEC		-0.0770***			
		(0.0288)			
CEP			-0.0566***		
			(0.0207)		
JI				-0.0202*	
				(0.0117)	
ROP					-0.0571**
					(0.0235)
PSAVEST	-0.0227**	-0.0266***	-0.0204**	-0.0874***	-0.0298***
	(0.00898)	(0.00881)	(0.00954)	(0.0265)	(0.0110)
PR	0.0698***	0.0385***	0.0578**	0.0131	0.0824***
	(0.0101)	(0.0105)	(0.0263)	(0.0114)	(0.0286)
EBT_TA	-0.0714*	-0.0351***	-0.0431***	-0.0199*	-0.0698*
	(0.0411)	(0.0125)	(0.0158)	(0.0105)	(0.0410)
F_COM_TA	0.0323***	0.0266*	-0.0320***	2.037**	0.0553**
	(0.0118)	(0.0144)	(0.0112)	(0.822)	(0.0236)
L.CAR	0.0215*	0.0244*	0.0315**	0.0366**	0.0694***
	(0.0109)	(0.0127)	(0.0135)	(0.0153)	(0.0142)
lnCONCENT	-0.127***	-0.0832***	-0.0563***	-0.0689***	-0.0724***
	(0.0384)	(0.0122)	(0.0106)	(0.0184)	(0.0129)
lnGDP	-0.0524***	- 0.0358***	-0.0291***	-0.0338***	-0.0306***
	(0.0129)	(0.00891)	(0.00790)	(0.00948)	(0.00789)
Constant	0.117***	0.0783***	0.0651***	0.678**	0.0611***
	(0.0281)	(0.0213)	(0.0188)	(0.280)	(0.0190)
Observations	401	406	406	398	401
No. of instruments	41	41	41	38	41
AR1 (p-value)	0.0331	0.0244	0.0242	0.398	0.0281
AR2 (p-value)	0.1065	0.1058	0.1052	0.1407	0.1059
Hansen-J (p-value)	0.631	0.611	0.571	0.667	0.706

*Note: *** p<0.01, ** p<0.05, * p<0.1.* DLLP represents discretionary loan loss provision, l.DLLP represents the lag of discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, PSAV represents political stability and absence of violence, PR represent political rights, EBT_TA represents earnings before tax scaled by total assets, l.CAR represent the lag of capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnBCON represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

From column 1 in Table 9, at 1% significant level, the study reports a negative significant effect of creditor right protection on earnings management behaviour of banks in our sampled SSA economies. This finding is not

surprising because in an economy characterized by strong creditor right protection, creditors are able to enforce their rights and limit bank managers ability to manipulate earnings. Once creditors have rights to withdraw their deposit subsequent to bank's earnings management behaviour, those rights alone serve as a disciplinary mechanism. In a similar vein, our results also suggests that when banks themselves are able to enforce seizure of collateral, there will be less needed to manage loan loss provision. Our results corroborate the arguments of Ashraf and Zheng (2015) and Kanagaretnam, Lobo and Wang (2015).

In support of the argument that strong contract enforcement reduces earnings management behaviour of banks, we do find in columns 2 and 3 of Table 9 that lower contract cost and number of procedures in enforcing contracts exhibit a significant negative relationship with banks' earnings management. This could be that a legal system that is characterized by low cost and fewer procedures of contract enforcements can incentivize banks' stakeholders to demand accountability and transparency in banks' reporting practices. In such circumstances, managers are less likely to engage in earnings management behaviour.

On the contrary, high contract enforcement costs and number of procedures can deter bank stakeholders from demanding accountability and transparency in firms' reporting practices, because of the sheer cost of enforcing that management conform to good accounting practices. Also, high number of contract enforcement procedures requires additional effort and resources, discouraging stakeholders to defend their contractual rights with managers, and eventually provide room for managers to engage in EM. This

result is in line with Habib, Ranasinghe, Wu, Biswas and Ahmad (2022) who argue that managers are less likely to benefit from earnings management if perfect market conditions like costless contract enforcement holds.

Further, the results in Table 9 provide evidence to support the hypotheses that judicial independence and reliability of police has a negative influence on earnings management of banks, indicating that independent judiciary and reliable police are needed to deal with wrong doing like earnings management behaviour of banks. Our findings support the argument made by Jensen and Meckling (1976) that judicial independence enhances the rights of bank stakeholders, such as the power to hold bank managers accountable, and hence lessens the degree to which banks engage in earnings management. This finding corroborates the arguments of Christopoulos et al. (2022). The results on reliability of police shows the invaluable role played by the police system in reducing EM behaviour of banks, as they form part of the overall legal architecture of an economy. The possible economic intuition here is that a reliable police system can facilitate investigations and possible prosecution, when necessary (Ball & Shivakumar, 2008), and therefore alter bank managers who may incline to engage in earnings management.

Also, the result in Table 9 shows that earnings management of banks is negatively associated with political stability. This result is in line with the argument that there will be lesser incentive for bank managers to engage in earnings management in an economy that is politically stable because earnings and cashflows tend to be very stable in such environments. Also, in line with the argument of Dai and Ngo (2013), stable earnings and cashflows enhances the ease with which financial statement users detect earnings management.

However, it can be observed from Table 9 that bank earnings management is positively associated with political rights. These results could mean that in economy that has strong political rights, bank managers could be confronted with intense pressure to maximize earnings, and this is in line with Qi et al. (2014).

For the control variables, earnings before tax, banking sector concentration and GDP exhibit a negative relationship with earnings management of banks. This evidence shows that when banks make a higher level of earnings before tax and loan loss provision, they are less likely to engage in earnings management because of the existing high earnings. This corroborates the findings of Taylor et al. (2023). Since high level of concentration signifies a less competitive banking sector, the negative coefficient of banking sector concentration could be that low level of competition do not incentivize banks to manage earnings but rather a high level of banking sector competition may incentivize banks to manage earnings in the quest to survive. The result on GDP suggests that banks are less likely to manage earnings in periods of economic prosperity.

The positive coefficients of fees and commissions income shows that banks that are characterized by large fees and commission tend to increase their DLLP to signal that the bank is well-diversified and safe, with interest in non-traditional bank activities (*see* Hasan & Hunters, 1999). The lag of the capital adequacy ratio mostly exhibited a positive effect on earnings management in all the columns of Table 9. This is probably because, due to the regulatory pressure, banks that previously have lower CARs may want to signal an improvement in the next period and would therefore incentivize

managers to engage in earnings management to boost financial health (Kanagaretnam et al., 2004). Another possible interpretation is that previously low CARs could be perceived as a sign of weakness and therefore managers could management earnings in the next period to improve stability (Ahmed et al., 1999).

Table 10 presents the results on how political stability modulates the connection between contracting institutions and earnings management.

Table 10: Regression results on the role of political stability in the relationship between contracting institutions and earnings management of banks in SSA

	(1)	(2)	(3)	(4)	(5)
L. DLLP	0.592 ***	0.615***	0.671***	0.677***	0.614***
	(0.0413)	(0.0519)	(0.0578)	(0.0616)	(0.0326)
CRP1	-0.132**				
	(0.0511)				
CRP* PSAVEST	-0.0331***				
	(0.0112)				
CEC		-0.0891***			
		(0.0257)			
CEC*PSAVEST		-0.0541**			
		(0.0221)			
CEP			-0.0676***		
			(0.0227)		
CEP* PSAVEST			-0.0813**		
			(0.0331)		
JI				-0.0414***	
				(0.0102)	
JI*PSAVEST				0.0561**	
				(0.0231)	
ROP					-0.0873***
					(0.0254)
ROP*PSAVEST					-0.0334***
					(0.0105)
PSAVEST	-0.0238**	-0.0467***	-0.0314**	-0.0648***	-0.0482***
	(0.0101)	(0.0068)	(0.0098)	(0.0369)	(0.0101)
PR	0.0982***	0.0445***	0.0678**	-0.0331	0.0844**
	(0.0109)	(0.0115)	(0.0269)	(0.0210)	(0.0365)
EBT_TA	-0.0824**	-0.0557	-0.0711*	-0.0799***	-0.0998***
	(0.0412)	(0.0342)	(0.0368)	(0.0251)	(0.0341)
F_COM_TA	0.0721***	0.0644***	0.0593***	0.0778***	0.0873**
	(0.0283)	(0.0234)	(0.0212)	(0.0121)	(0.0406)
L.CAR	0.0525***	0.0643***	0.0654***	0.0626**	0.0556***
	(0.0109)	(0.0237)	(0.0235)	(0.0313)	(0.0212)
lnCONCENT	-0.141***	-0.0912***	-0.0869***	-0.0819***	-0.0614***
	(0.0414)	(0.0212)	(0.0261)	(0.0411)	(0.0226)
lnGDP	-0.0614***	- 0.0578***	-0.0611**	-0.0414***	-0.0441**
	(0.0219)	(0.0219)	(0.0291)	(0.0148)	(0.0191)
Constant	0.207***	0.0613***	0.0512**	0.0782***	0.0817**

	(0.0181)	(0.0216)	(0.0211)	(0.0186)	(0.0402)
Observations	401	406	406	398	401
No. of instruments	38	42	38	40	42
AR1 (p-value)	0.0373	0.0414	0.0421	0.0482	0.0312
AR2 (p-value)	0.2165	0.1557	0.1523	0.1744	0.1597
Hansen-J (p-value)	0.439	0.410	0.441	0.553	0.661

Note: *** *p<0.01*, ** *p<0.05*, * *p<0.1*. DLLP represents discretionary loan loss provision, l.DLLP represents the lag of discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, PSAV represents political stability and absence of violence, PR represent political rights, EBT_TA represents earnings before tax scaled by total assets, l.CAR represent the lag of capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnBCON represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

In Table 10, it can be observed that the interaction terms between political stability and the contracting institutions are mostly negative. This pinpoints the invaluable role of political stability in shaping the efficacy of contracting institutions in reducing earnings management of banks in SSA. Specifically, the interaction term between creditor right protection and political stability is negative, signifying that the relevance of creditor rights are more profound in stable political regime as political instability deteriorates the stability of creditor rights. Thus, in an unstable political regime, bank managers are more likely to engage in earnings management on the assumption creditor rights in such regime is not safeguarded.

Also, the interaction term between the proxies for contract enforcement and political stability is also negative. The economic intuition behind these results could be that political stability enhances stability of contracts as well as the cashflows from contracts and thus bank managers are not under pressure to manage earnings. Contrary to the earlier argument, we rather got positive collaboration between political stability and judicial independence. In line with the finding of Aydin (2013), these results show that in weak democracies such as that of SSA economies, the bid to maintain

political power significantly reduces independence of Judiciary, and thus incentives bank managers to management earnings. Finally, the interaction of police reliability is negative, lending support to our argument that political stability strengthens contract enforcement institutions.

The study also presents the role of political rights in the relationship between contracting institutions and earnings management of banks in Table 11.

Table 11: Regression results on the impact of political rights on the contracting institutions – earnings management nexus of banks in SSA

	(1)	(2)	(3)	(4)	(5)
L. DLLP	0.673 ***	0.665***	0.679**	0.679***	0.644***
	(0.0438)	(0.0599)	(0.0584)	(0.0622)	(0.0325)
CRP	-0.104**				
	(0.0412)				
CRP* PR	-0.0234**				
	(0.0112)				
CEC		-0.0597***			
		(0.0154)			
CEC*PR		-0.0411***			
		(0.0121)			
CEP			-0.0577***		
			(0.0129)		
CEP* PR			-0.0713**		
			(0.0321)		
JI				-0.0216**	
				(0.0102)	
JI*PR				-0.0664***	
				(0.0137)	
ROP					-0.0776***
					(0.0194)
ROP*PR					-0.0639***
					(0.0112)
PSAV	-0.0289***	-0.0497***	-0.0301***	-0.0518**	-0.0489***
	(0.0111)	(0.0078)	(0.0098)	(0.0257)	(0.0100)
PR	0.0712***	0.0645***	0.0718***	0.0416**	0.0741***
	(0.0196)	(0.0135)	(0.0168)	(0.0179)	(0.0265)
EBT_TA	-0.0724***	-0.0599**	-0.0718***	-0.0529***	-0.0699***
	(0.0212)	(0.0242)	(0.0261)	(0.0158)	(0.0211)
F_COM_TA	0.0661***	0.0689***	0.0593***	0.0712***	0.0613**
	(0.0201)	(0.0245)	(0.0221)	(0.0228)	(0.0261)
L.CAR	0.0529***	0.0647***	0.0599**	0.0760***	0.0676***
	(0.0100)	(0.0231)	(0.0238)	(0.0213)	(0.0119)
lnCONCENT	-0.149***	-0.0828***	-0.0876***	-0.0897***	-0.0674***
	(0.0442)	(0.0228)	(0.0211)	(0.0401)	(0.0216)
lnGDP	-0.0668***	- 0.0611***	-0.0619	-0.0714***	-0.0449**
	(0.0239)	(0.0216)	(0.0391)	(0.0183)	(0.0191)
Constant	0.271***	0.0816***	0.0786***	0.0686***	0.0874***
	(0.0181)	(0.0216)	(0.0207)	(0.0206)	(0.0302)
Observations	401	406	406	398	401
No. of	40	40	39	39	40

instruments					
AR1 (p-value)	0.0672	0.0564	0.0721	0.0486	0.0656
AR2 (p-value)	0.2045	0.2017	0.2153	0.2414	0.2237
Hansen-J (p-value)	0.535	0.516	0.463	0.452	0.561

*Note: *** p<0.01, ** p<0.05, * p<0.1.* DLLP represents discretionary loan loss provision, l.DLLP represents the lag of discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, PSAV represents political stability and absence of violence, PR represent political rights, EBT_TA represents earnings before tax scaled by total assets, l.CAR represent the lag of capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnBCON represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

Generally, it can be observed that the interactions term between political rights and each of contracting institutions proxies is negative. This signifies that in a strong political rights regime, the relevance of contracting institutions is strongly projected by the high level of public scrutiny and intense media, and therefore incidences of bank earnings management are likely to be low.

Summary and Conclusions

Firms in economies with weak institutional setting are highly susceptible to information opacity than firms in economies with stronger institutional setting. In this study, we highlighted the role of contracting institutions in reducing earnings management of banks in SSA economies. Again, this study demonstrated the conditions under which such relationship may be altered by examining political institutions's role in the relationship. By employing several measures of contracting institutions, the study mostly found that contracting institutions reduce earnings management of banks.

The SGMM estimates also reveal that the negative relationship between contracting institutions and earnings management is more profound in economies with stronger political institutions than economies with weak

political institutions. This also shows the invaluable role of stronger political rights in reducing earnings management behaviour. In line with this, strengthening contracting institutions is very vital in reducing the extent of earnings management among banks and thus should be at the center of policy interest. In addition, policy makers should put in measures to strengthen political institutions.

CHAPTER SIX

EARNINGS MANAGEMENT AND PERFORMANCE OF BANKS IN SUB-SAHARAN AFRICA: THE ROLE OF CONTRACTING INSTITUTIONS AND SARS

Abstract

This empirical chapter's goal is to investigate the link between bank earnings management and performance in sub-Saharan Africa, with a focus on how the strength of contracting institutions and auditing and reporting standards moderate the relationship. This chapter makes use of a panel dataset that includes many accessible bank- and country-level variables from 2007 to 2021. The models were estimated in this chapter using the System Generalized Method of Moments (SGMM). The findings from the SGMM estimates suggest that earnings management positively influences performance of banks in sub-Saharan African countries. Further, the findings reveal that strength of auditing and reporting standards, and contracting institutions strengthen the relationship. In economies where there is high commitment to improve the SARS and contracting institutions, both can constrain the opportunistic outcomes of earnings management. This will result in efficiency outcomes of earnings management and eventually improve bank performance.

Introduction

In order to better understand the link between banks' performance and earnings management in sub-Saharan Africa, this research looks at the roles that contracting institutions, auditing and reporting standards play in the link. This is driven by the growing empirical and theoretical discussion on the connection between earnings management and firm performance. This research makes several contributions to the body of existing literature. To the best of our knowledge, this is the first study to look at the connection between earnings management and performance in the context of SSA banks. The focus of recent research, like that of Boachie and Mensah (2023), is mostly on non-financial firms in the Anglophone SSA economies. Additionally, this study is the first cross-national investigation of how contractual institutions affect the connection between bank performance and earnings management. We define contractual institutions as systems that guarantee the execution of agreements between two parties, none of which are the state, based on the argument of Acemoglu and Johnson (2005).

By examining how the strength of auditing and reporting standards moderates the relationship between earnings management and performance, this study differentiates itself from other studies (*like* Amidu & Issahaku, 2019) that investigate the role of IFRS adoption in earnings management and performance of banks. This study argues that compliance to auditing and reporting standards may provide a nuanced understanding of the role of reporting standards in reducing or enhancing earnings management behaviour and improving performance of banks. This study offers more empirical support for the New institutional theory by using contractual institutions and

SARS as moderating variables in the earnings management-performance connection.

Assessing the role of contracting institutions and SARS in the earnings management-performance relationship is motivated by the burgeoning theoretical and empirical debate on the earnings management-performance nexus. A number of studies find a positive relationship (*see* Ngunjiri, 2017; Fang, 2008), while some find a negative relationship (Debnath, 2017; Alhadab & Al-Own, 2017), and finally some find insignificant or mixed results within the same study (Moshi, 2016; Lee, Li, & Yue, 2006). Some of these studies attribute the differences in findings to measurement of earnings management, the type of firm, the estimations techniques and the presence of some other factors that could moderate the relationship. This study aligns itself with the last school of thought to examine how and why contracting institutions and SARS could explain the differences in the earnings management and performance relationship.

In this regard, the relevance of this study springs from examining the relationship between the earnings management and performance in an institutional context where the Strength of Auditing and Reporting Standards (SARS) and contracting institutions are fundamentally different from that of advanced countries. Even though previous studies might have examined how the earnings management-performance relationship is confounded by other institutional factors, the SSA region represents a setting where the implementation or the strength of institutional structures is weaker than that of advanced economies (*see* Abeka, Gatsi, Appiah & Agyemang,2022). In sum, the purpose of this study is to answer four important research questions: (i)

what is the relationship between earnings management and performance within the context of banks in SSA? (ii) why should contracting institutions moderate the relationship between earnings management-bank performance connection in SSA? (iii) how different is the EM-performance nexus in economies that has strong Auditing and Reporting Standards (ARS) from economies that have weak ARS? (iv) why does this study focus on the SSA context? The justifications for these four essential research questions are provided in the subsequent paragraphs.

The extant literature on earnings management and performance has well-documented that managers take advantage of the discretionary nature of reporting standards to alter earnings figures for various reasons. There are two key reasons for the focus of this study on the banking sector. First, policy makers place huge importance on the banking sector since its soundness is very vital to the entire economy. Second, the common use of loan loss provision has commonly been employed as a measure of earnings management makes examination of the EM-performance relationship within the context of banks much more important. Reporting an uneconomically realistic low loan loss provision numbers could signal high level of loan recovery and bank performance, even if it does not reflect the current economic reality and performance of the bank.

Also, managers of banks are more likely to exaggerate the firm's earnings to attract more investors within a competitive banking sector. Growing evidence of cross-border banking in (SSA) indicates that the sub-region's banking sector has become more competitive (Ngwu et al., 2019), which might encourage banks to manage profits. This motive of earnings

management may be more profound in the wake of tightening of capital structure has taken the centre stage of banking sector regulations. In line with this argument, Healy and Wahlen (1999) earlier highlighted that "the evidence is consistent with firms managing earnings to window-dress financial statements prior to public securities' offerings, to increase corporate managers' compensation and job security, to avoid violating lending contracts, or to reduce regulatory costs or to increase regulatory benefits" (p. 368).

Based on the positive accounting theory (Watts & Zimmerman, 1978;1990), manager will alter accounting numbers to pursue their self-interest and yet send a good signal to various stakeholders of a bank. In dealing with the opportunistic behaviour of bank managers, governance structures are instituted to re-align the interest of managers with that of the various stakeholders. Anginer et al. (2018) cautioned against the shareholder perspective to banking governance since it leads to excess risk taking, but rather argued for a stakeholder perspective, where there is sanctity of contract between the banks and its various stakeholders. Since the various stakeholders of banks may be highly susceptible to earnings opacity, they are more likely to rely on external governance mechanisms to reduce the extent of information asymmetry. Internal governance structures are mainly employed by shareholders to require high rate of return on their investment (Jensen & Meckling, 1976).

Conversely, external governance structures go beyond corporate control and is rather concerned with how the stakeholders could be protected from expropriation by managers (Duong, Kang & Salter, 2022). The external governance structures employed in this study are contracting institutions and

ARS. Even though earnings management behaviour occurs within the bounds of external governance structures, contracting institutions and ARS inadvertently appear to be missing in the debate. There are several reasons to suspect that contracting institutions and ARS could alter the EM-performance relationship. Weak contract enforcement mechanisms could allow managers discretion in performing their side of firm contracts, leading to undesirable practices like opportunistic earnings management. Therefore, strong contract enforcement mechanisms are expected to limit opportunistic EM practices and eventually improve the credibility and performance of banks.

The contracting institutions employed in this study includes creditor right protection, cost of enforcing contracts, number of contract enforcement procedures, judicial independence and reliability of police. In our view, these institutions will provide excellent oversight on the contracts between bank managers and key stakeholders like loan customers, depositors and regulators, thereby limiting opportunistic earnings management behaviour and enhancing bank profitability. For instance, in economies where there is high level of creditor right protection, bank managers may not be incentivized to manage earnings figures to portray an unrealistic view of bank performance. This is because, bank managers know that in a case where the false figures lead to bank collapse, the depositors will be able to enforce repayment of their deposits. SARS may also reduce the extent of earnings management and realistically increase bank performance.

This study focuses on the banking sector of SSA economies. The expansion of cross-border banking throughout the continent is proof that the banking industries in majority of SSA nations have liberalized (*see* Ngwu et

al., 2019). On the one hand, the influx of foreign banks could have positive implication for the host economy's banking sector in terms of efficiency and stability. On the other hand, the competition created by foreign banks could incentivise bank managers to manage earnings figures to remain competitive. Put differently, underperforming banks would have to manage earnings because low level of profits increase the risk of fold-up from the banking market (Becchetti & Sierra, 2003). Prior studies show that pressurized firms have a higher probability of bankruptcy and therefore will be more motivated to manage earnings (Beneish, Press & Vargus, 2012). Therefore, the continuous increase in competition in the SSA banking sector could predispose banks to manipulate earnings information.

The rest of the chapter is structured as follows: the literature review and hypotheses development, empirical methodology, results and discussions and finally summary and conclusions.

Literature Review

Theoretical Framework

The positive accounting theory has been employed to explain why firms engage in earnings management practices. The prior literature on positive accounting theory argued that accounting choices are primarily determined by compensation contracts, debt contracts and firm's political processes (Watts & Zimmerman, 1978). However, such arguments were founded on the theory of the firm, which highlighted the importance of the contractual relationship between shareholders and managers. A ten-year account of literature on the positive accounting theory after the seminal paper by Watts and Zimmerman (1978) instead revealed that accounting researchers

were gradually taking a more general approach to motives of accounting choices other than just agency relationship between managers and shareholders (*see* Watts & Zimmerman, 1990).

There is a possibility for a number of contracts to influence organizational choices and the fact that prior studies mainly concentrated on agency contracts only provided a limited view on motives of organisational choices (Klein 1983; Smith 1988). Subsequently, Watts and Zimmerman (1990) introduced the contemporaneous positive accounting theory which pointed out that a nexus of contracts between firms and its various stakeholders could influence and be influenced by accounting choices. For instance, firm executives can employ accounting techniques to decrease or increase reported earnings to signal high performance and gain higher compensations (Bornemann et al., 2012). Earnings management could be harmful or beneficial to performance depending on the contracting cost and the extent to which managerial discretion in reporting accounting numbers is allowed. Specifically, contracts that employ accounting numbers becomes ineffective in bringing contracting parties' and managers interests in alignment if the accounting regulatory body allows some discretion in reporting accounting numbers (Watts & Zimmerman, 1990).

Thus, this study argues that, to reduce managerial self-interest which increases their wealth at the expense of firm performance, institutional structures such as contract enforcement mechanisms and strong auditing and reporting standards are instituted to align the interest of various stakeholders with that of management. Our argument is founded on the New Institutional Theory that highlights the role of institutional structures in shaping motives of

economic agents (including managers) (*see* Amenta & Ramsey, 2010). Altogether, the relationship between earnings management and bank performance can be influenced by contracting institutions and the SARS. In this regard, the study employs the positive accounting theory and the new institutional theory to develop the study hypotheses in the next section.

Empirical Literature Review and Hypotheses Development

The study builds hypotheses on the role of contractual institutions and SARS in the link between earnings management and bank performance in the next two subsections after presenting an empirical evaluation. The link between EM and performance is explained in the first subsection. The relationship of EM, SARS, and contracting institutions on performance is also discussed in the next subsection.

The influence of the Earnings Management on Performance

A preponderance of EM literature that is founded on the positive accounting theory and the agency theory have demonstrated that firm performance is associated with its earnings management practices. Also, the relationship between earnings management and firm performance have become more critical to the various firm stakeholders in the quest to avoid further accounting scandals and its associated losses. However, the burgeoning literature have provided mixed results (Chakroun, Ben Amar & Ben Amar, 2022). Some studies have shown a positive link between EM and performance of firms. For instance, Lee et al. (2006) employed a sample of nonfinancial firms to demonstrate that EM positively influences performance and growth of firms. Mangala and Dhanda (2019) examined the relationship between EM and performance of IPO enterprises and found that EM increased the

performance of firms after the IPO. Similarly, Mensah and Onumah (2023) find that EM practices as measured by discretionary accruals is positively related to the performance of non-financial firms.

Conversely by measuring firm performance with ROA, Chakroun et al. (2022) find that EM reduces firm performance. Similar prior studies like Gill et al. (2013) and Mahdavi Ardekani et al. (2012) find that firm performance is negatively associated with EM practices. There are several reasons why accounting discretion may be negatively related to firm performance. Firms may employ EM practices to transfer stakeholder wealth to shareholders by not presenting a true and fair view of firm performance. Since earnings is generally considered as an indicator of firm performance, EM could affect the behaviour of stakeholders (Price & Sun, 2017; Abaoub and Amar, 2010). Therefore, any stakeholders' suspicion of EM by firms can affect corporate reputation, public confidence, attract regulatory sanctions, and subsequently reduce firm performance (Bouaziz et al., 2020; Mahrani & Soewarno, 2018).

From the stakeholder theoretical perspective of corporate governance, EM is likely to have a negative or a positive relationship with firm performance. This may be prevalent in the banking industry where stakeholders play a key role influencing managers behaviour (*see* Anginer et al., 2018). Thus, when there are strong institutional structures that deals with managerial and shareholders expropriation of stakeholders, EM can improve bank performance. This leads to the hypothesis that:

H3a: Earnings management has a positive effect on performance of banks.

The Effect of the Interactions among Earnings Management, SARS, Contracting Institutions on Bank Performance

Prior studies from the New Institutional theoretical perspective have pointed out that institutional structures are relevant to constraining behaviour of economic agents, whether in science politics, finance or accounting (Amenta & Ramsey, 2010). The need for appropriate disclosures in corporate governance processes was emphasized by La Porta et al. (2002). Thus, institutional structures like auditing and reporting standards are likely to create a culture of transparency and accountability in the reporting practices of firms. Further, it has been contended that compliance with auditing and reporting standards reduces earnings management practices to ensure reporting quality.

Incidences of financial reporting irregularities are likely to be relatively lower in economies characterized by strong auditing and reporting standards. Arguably, mere adoption of auditing and reporting standards may not help in constraining managerial opportunism as inherent in these standards is the discretion in its application. Rather, in economies where auditing and reporting standards are stronger, managerial opportunism is likely to be lower (*see* Adela et al., 2023). From the foregoing arguments, it is reasonable to assume that strong auditing and reporting standards can affect stakeholder perception of reporting quality positively, increase corporate reputation, and reduce regulatory sanctions. The reduced cost and the associated benefits would subsequently increase bank performance. Therefore, in the context of strict auditing and reporting standards, the negative impact of earnings management on company performance may be mitigated. This leads to the hypothesis that

H3b: SARS positively moderates the EM-performance relationship

Trust can be built between stakeholders and firm executives when there are strong contract enforcement mechanisms. Thus, if there is a large number of legal procedures required to enforce contracts, various contracting parties are likely to renege on their contractual obligations, giving rise to managerial opportunism. Conversely, strong contract enforcement mechanisms can deter managers from expropriating stakeholders, reduce EM and enhance firm performance. Altogether, contracting institutions can enhance contract enforcement, reduce EM practices of firms, boost stakeholders' confidence in firm's reporting practices and increase bank performance subsequently. Thus, this study hypothesizes that

H3c: Contracting institutions positively moderates the EM-performance relationship of banks.

Methodology

Data Sources

This study integrates data from many sources to investigate the influence of SARS and contracting institutions on the relationship between EM and bank performance. The bank level data are sourced from bankscope database. We begin with the entire dataset on banks in Africa and then refine it based on some criteria to obtain the final sample. First, to avoid double-counting of banks that report unconsolidated data and consolidated data, we remove the unconsolidated data. Next, we delete the data of banks that have no available data for the key variables of interest, i.e., bank performance and earnings management. Afterwards, we connect the bank-level data with their respective country level data on contracting institutions and ARS.

Econometric Methodology

This study employs a panel data set between the period 2007 – 2021 to examine the relationship among earnings management, contracting institutions, ARS, and bank performance. The study specifies the baseline regression model as follows:

$$Performance_{i,j,t} = \alpha + \beta.Performance_{i,j,t-1} + \gamma.EM_{i,j,t} + \sigma.CI_{j,t} + \omega.SARS_{j,t} + \theta.Y_{i,j,t} + \varphi.Z_{j,t} + \mathcal{E}_i \ldots\ldots(1)$$

Where the subscripts i, j, t respectively represents the bank, country and year, *performance* is the bank performance indicators, EM represents bank's earnings management, CI represents a matric of contracting institutions, SARS represents the strength of Auditing and Reporting standards,, Y is a matrix of bank-level control variables, Z is a matrix of country-level control variables, $\mathcal{E}_i$ represents the error term. The bank-level controls employed in this study are bank size, regulatory capital and commission and fees income. For the country-level control variables in Z, the study employs the banking sector concentration, political rights and GDP. To account for the possible time-dependent effects, the study includes year dummies in the dataset.

To test the moderating effect of SARS in the EM-performance relationship, the study modifies model 1 as follows:

$$Performance_{i,j,t} = \alpha + \beta.Performance_{i,j,t-1} + \gamma.EM_{i,j,t} + \sigma.CI_{j,t} + \omega.SARS_{j,t} + \eta.(EM * SARS)_{i,j,t} + \theta.Y_{i,j,t} + \varphi.Z_{j,t} + \mathcal{E}_i \ldots.(2)$$

Where $EM * SARS$ presents a matrix of the interaction term between earnings management and SARS and η is the main parameter of interest in the model.

To test the moderating effect of contracting institutions in the EM-performance relationship, the study modifies model 1 as follows:

$$Performance_{i,j,t} = \alpha + \beta.Performance_{i,j,t-1} + \gamma.EM_{i,j,t} + \sigma.CI_{j,t} + \eta.(EM * CI)_{i,j,t} + \omega.SARS_{j,t} + \theta.Y_{i,j,t} + \varphi.Z_{j,t} + \mathcal{E}_i \ldots\ldots (3)$$

Where $EM * CI$ presents a matrix of the interaction term between earnings management and each of the contracting institutions and η is the main parameter of interest in the model.

The study estimates all the models with System Generalized Method of Moments (SGMM) due to dynamic nature of the model and potential endogeneity problems. One possible cause of endogeneity in the models specified is the issue of reverse causality (Hall, 2004) between earnings management and bank performance. Based on the agency theory, one will naturally predict that the EM-performance causality should run from EM to performance. However, some recent studies (Alexander, 2017; Sari, Djohanputro, & Kountur, 2021) have rather argued the reverse by demonstrating causality that runs from performance to earnings management. Such view holds that, managers could reduce earnings management when the earnings reported in the previous period is high.

Another cause of endogeneity is the persistence in bank profits. Recent studies have demonstrated that former level of bank profits affect current level (Le & Ngo, 2020; Li, 2019). The value of β of the lag of the performance variable in the model specification shows the ability of banks to remain the same profit horizon. The inclusion of the lagged dependent variable in the models makes the model dynamic and thus should be estimated by a dynamic model estimator. Among the dynamic model estimators, the system

GMM has been found to be adequate when the number of cross sections is larger than the number of time series (Arrelano & Bond, 1990).

Arrelano and Bond (1990) and Blundell and Bond (1995) claimed that the SGMM estimator is suitable for handling endogeneity resulting from reverse causality and dependent variable's persistence. The study therefore employs the SGMM to estimate all the models. Specifically, it employs the two-step SGMM based on its efficiency over the one-step SGMM (Anderson & Hsiao, 1981; Arellano, 2003). To evaluate the suitability of the SGMM estimations, we then run the Hansen J-statistic and the Arrelano and Bond autocorrelation [(AR1) and (AR2)]test. The Arrelano and Bond autocorrelation test has null hypothesis of no autocorrelation whilst the Hansen J-statistic test has null hypothesis of instrument validity.

Variables Measurement

Bank performance measure

The study employs return on assets (ROA) as the main measure of performance. It reflects how well the business has performed in the utilization of the capital provided by both insiders and outsiders (Rashid, 2020). A natural assumption here is that the effect of EM on ROA reflects how EM sends a signal to all financiers of a bank.

Earnings management measure

Banking literature have primarily focused on employing loan loss provision as a measure of earnings management due to several reasons. First, compared to other forms of accruals, this accrual has a higher magnitude, and it is significantly correlated with total accruals (Beatty & Liao, 2014). Second, since bank managers compute loan loss provisions to depict the losses that

they expect on a present loan portfolio, the inherent discretionary part allows them to engage in practices that show that they are managing earnings. Also, managers are incentivized to employ LLP as an earnings management tool since its large magnitude sends signals on the bank's financial health (Greenawalt & Sinkey ,1988). Thus, a preponderance on bank's earnings management literature have employed loan loss provision as a measure of earnings management. However, the total LLP may not truly reflect the earnings management incentives of banks, and thus Liu and Ryan (2006) advise the use of the discretionary component of LLP as an earnings management measure.

To this end, we use the following methodology, following Fan et al. (2019), Beatty and Liao (2014), and Cohen et al. (2014), and use the discretionary component of LLP as the primary proxy for the extent of earnings management. We specify a basic regression equation to estimate the key determinants of LLP using fixed effect estimator. To prevent scaling problem and impact of size on the regression results, which could possibly weaken the explanatory power of the regressors (*see* Taylor et al., 2023), we follow extant literature (Balboa et al., 2013; Taylor et al., 2023) and scale the bank level variables by total assets. Next, we predict the error term and take this as a measure of earnings management. Based on the argument of Beatty et al. (2002), we remove the potential effect of outliers on the error term by winsorising the data at 1% and 99%, based on the criterion employed by Taylor, Awuye and Cudjoe (2023). The basic regression equation is specified as:

$$LLP_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_1 \Delta LOAN_{it} + \beta_2 LCO_{it} + \beta_3 LLA_{it-1} + \beta_4 \Delta NPL_{it-2} + \beta_6 \Delta NPL_{it-1} + \beta_7 \Delta NPL_{it} + \beta_8 NPL_{it+1} + \varepsilon_{it}$$

Where LLP represents Loan loss provision, size represents bank size as measured by the natural log of total assets, $\Delta LOAN$ represents the difference between the total loans in the current period and 1 year lag, LCO represents net loan charge offs, LLA represents Loan Loss Allowance and ΔNPL_{it-2} represents difference between the non-performing loans in 2-year lag and 3-year lag, ΔNPL_{it-1} represents the difference between the non-performing loans in 1-year lag and 2-year lag, ΔNPL_{it} represents the difference between the non-performing loans in the current period and 1-year lag, and 2-year lag, NPL_{it+1} difference between the non-performing loans in year t+1 and t, and ε is the unexplained component of the regression. The error term is therefore regarded as the discretionary part of the loan loss provision.

Contracting institutions and SARS measures

Following the argument of Acemoglu and Johnson (2005), this study employs five variables to proxy for contracting institutions – Creditor Rights Protection (CRP), Cost of Enforcing Contract (CEC), Legal Procedures in Enforcing Contracts (LPEC), Judicial Independence (JI) and Reliability of Police (RoP). The details of the measurement of the study variables are pointed out in Table 12. Following the study of Adela et al. (2022), we measure the Strength of Auditing and reporting standards by employing data from the Global competitiveness Index report.

Control variables' measurement and justification

Following both empirical and theoretical literature, this study controls for other variables that have been reported to impact bank performance. In this regard, this study controls for bank level variables such as bank size, capital adequacy ratio, and fees and commission income. We also control for banking

sector structure using banking sector concentration. Finally, we control for the institutional quality and overall macroeconomic conditions using political institutions and gross domestic product respectively. The details of the measurement of the control variables are presented in Table 12. In line with studies like Heinrich and Dai (2016) as well as Lin and Fu (2017), we control for bank size because large banks are able to leverage on economies of scale, incur relatively lower cost and increase their performance.

A banks capital requirement can impact its performance in two ways. First, holding a large amount of capital increases the marginal cost of bank funding, increase lending interest, reduce demand for loans and hence lowers bank overall performance (Le, Nasir & Huynh, 2023). Conversely, it is also argued that a high capital adequacy ratio increases monitoring by shareholders, reduces the problem of moral hazard and then increase bank performance (Tan & Floros, 2013). Due to the effect of capital adequacy on bank performance, we control for it in this study. Income diversification allows banks to tap into new revenue streams, thereby potentially improving profitability (Ashyari & Rokhim, 2020). Thus, it is expected that fees and commission income would affect bank performance positively. Bank sector concentration is predicted to have an impact on bank performance based on the "competition-fragility" and "competition-stability" argument by Allen and Gale (2005). Weak political rights reduce transparency in the relationship between banks and government authority (Trueman & Titman, 1988). Therefore, there is evidence that highly politically connected banks usually have high return on assets and therefore this study also controls for political

rights (*see* Nega Lakew & Adeleye, 2020). The details of the variables and how they are measured are presented in Table 12.

Table 12: Variables and Measurement

Variable Name	Measurement	Data Source
Bank performance	**Return on Assets**	Bankscope data base
Earnings management of Banks measure: Discretionary Loan Loss Provision	The calculation had already been discussed. High value shows high level of bank earnings management.	Bankscope data base
Strength of Auditing and reporting standards	Measured on a scale of 1 – 7. 1 = extremely weak; 7 = extremely strong	Global Competitiveness Report
Creditor Rights Protection (CRP)	Getting Credit, Strength of legal rights index. Constructed on a scale of 0 – 100, [0 = no protection and 100 = highest protection]	World doing business databases
Cost of Enforcing Contract (CEC)	Cost as a percentage of claims - Score is constructed on a scale of [0 -100] with higher values representing lower costs.	World doing business database
Legal Procedures in Enforcing Contracts (LPEC)	Number of procedures -Score is constructed on a scale of [0 -100] with higher values representing lower number of procedures.	World doing business database
Judicial Independence (JI)	Constructed on a scale of 1 – 7 [7 = Best]	Global Competitiveness Report
Reliability of Police (RoP)	Constructed on a scale of 1 – 7 [7 = Best]	Global Competitiveness Report
Political Rights	Average ratings on the quality of electoral processes, political pluralism and political participation, legislature and executives. This is constructed on a scale of 0 – 40.	Freedom House database
Bank Size	Quoted as "Natural logarithm of bank total assets"	Calculated using data from Bankscope data base
Capital adequacy ratio	Bank capital divided by its risk-weighted assets	Bankscope data base
Fees and commission income	Income generated by bank on non-traditional activities	Bankscope data base
Banking sector concentration	Quoted as "Banking sector Assets of three largest commercial banks as a share of total commercial banking assets. Economic theory suggests that a high level of concentration reduces competition and thus represent an inverse measure of competition"	Global financial development database
Gross Domestic Product.	"Gross Domestic Product at constant US 2015".	

Results and Discussion

Univariate statistics

Table 13 presents a summary of the descriptive statistics using the common samples option.

Table 13: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	547	1.506	1.304	-117.5	24.737
DLLP	547	.009	.02	-.048	.078
SARS	547	4.221	.834	2.134	6.727
CRP	547	50.941	18.152	19	100
CEC	547	48.044	20.167	0	94.276
CEP	547	44.202	14.186	0	83.92
JI	547	3.964	.912	1.286	5.743
ROP	547	3.960	.891	1.271	6.678
PR	547	19.014	10.245	-1.97	39
BSIZE	547	13.24923	1.527407	8.306654	18.65733
CAR	547	23.212	23.272	-214.8	262
F_COM_TA	547	57316.9	237827.31	0	2291807.6
BCONC	547	64.411	18.915	29.11	100
GDP	547	5.908e+10	1.090e+11	7.481e+08	5.094e+11

ROA represents Return on Assets, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, PR represent political rights, EBT_TA represents earnings before tax scaled by total assets, BSIZE represents bank size, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, BCONC represents banking sector concentration. GDP represents Gross Domestic Product.

The average return on assets is 1.506%, indicating that the returns provided for all parties who has contribute all forms of finances to the sampled banks is low. Since ROA reflects how efficiently management has utilized bank assets (Boachie & Mensah, 2022), a low ROA reflects the weak ability of bank managers to generate actual revenue through the usage of company assets and therefore may be indicative of a high probability of earnings management. The strength of auditing and reporting standards appears to be fairly above average, with a mean of 4.221 on a scale of 1 – 7. Most of the contracting institutions have average ratings close to a median rating of 50, on

a scale of 0 – 100. This shows some commitment made by our sampled SSA economies in improving their contracting institutions.

Bivariate Statistics

Based on the extent of variability within some of the variables, they were transformed before employing them in the correlation and regression analysis. For instance, the fees and commission income variable were scaled by total assets, the banking sector concentration and GDP variables were log transformed before employing them in the correlation and regression analysis. The study displays the variables' pairwise correlation in Table 14.

Table 14: Correlation Matrix

Variables	ROA	l.ROA	DLLP	CRP	CEC	CEP	JI	ROP	PR	BZISE	(F_COM_TA)	CAR	lnBCON	lnGDP	VIFS
ROA	1.000														
l.ROA	0.923***	1.000													1.26
DLLP	0.564**	0.223**	1.000												1.58
CRP	0.441*	0.321**	-0.473***	1.000											1.13
CEC	0.332**	0.229**	-0.339***	0.522***	1.000										1.33
CEP	0.165**	0.221***	-0.331***	0.116**	0.332**	1.000									1.32
JI	0.122**	0.271**	-0.119**	0.114***	0.145***	0.177*	1.000								1.96
ROP	0.106*	0.133**	-0.432	0.167	0.336**	0.153*	0.664**	1.0000							1.66
PR	0.345***	0.234*	0.422*	0.190**	0.113**	0.052*	0.235**	0.563***	1.000						1.76
BSIZE	0.234**	0.245*	0.145***	0.092	0.124**	0.209*	0.109*	0.191**	0.235**	1.000					1.99
F_COM_TA	0.196**	0.155**	0.161***	-0.029	0.045**	0.414**	0.650***	0.441***	0.254**	0.192***	1.000				2.03
CAR	0.234***	0.231**	0.216***	0.129**	0.011*	0.126**	0.319**	0.334**	0.610**	-0.019	0.169*	1.000			1.69
lnBCON	0.543**	0.229**	-0.057	-0.133***	-0.343***	0.442**	0.645***	0.457***	0.487**	0.0471	0.143***	-0.066**	1.000		1.45
lnGDP	0.434**	0.321***	-0.612***	0.152***	0.257***	0.662***	0.676**	0.338***	0.313***	-0.014	-0.063***	-0.106**	-0.452***	1.000	1.39

*** *p<0.01*, ** *p<0.05*, * *p<0.1*. ROA represents Return on Assets, l.ROA represens the lag of return on Assets, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, SARS represents strength of Auditing and reporting standards, PR represent political rights, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnCONCENT represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

From the pairwise correlation in Table 14, it can be observed that most of the regressors are significantly associated with the dependent variable, which points out some little evidence that omitting any of these regressors to lead to omitted variables bias. Notably, it could be seen that the lag of ROA is positively and significantly associated with the actual ROA, indicating persistence in the dependent variable and requiring the use of dynamic panel model estimator. Also, the lag of ROA has a significant association with the other regressors. Altogether, these correlation findings point out earnings management, SARS, contracting institutions and performance relationship, which is very vital to the choice of our estimation technique. Finally, it can be observed from Table 3 that that none of the pairwise correlation among the independent variables is greater than a magnitude of 0.80. according to Damodar (2004), there is no evidence of multicollinearity unless the pairwise correlation exceeds 0.80. A careful observation of the variance inflation factors also confirms that there is no multicollinearity among the variables since all the VIFS are less than 10 (in line with Chatterjee & Hadi, 2012).

Multivariate Analysis

The findings about the impact of DLLP, SARS, and contracting institutions on the performance of the banks in our sample are shown in this section. The diagnostics in all the regression results show that the results are adequate. Specifically, the p-values of the AR (2) tests in all the regression results leads to non-rejection of the hypothesis that there is no autocorrelation in the second order. Further, the p-values of all the Hansen J-tests shows that the instruments employed were exogenous and are valid. Finally, a

comparison of the number of groups vis-à-vis the number of observations shows that the estimates do not suffer from instrument proliferation.

Table 15: Regression results on the relationship among earnings management, SARS, contracting institutions and performance of banks in SSA
Dependent Variable: ROA

	(1)	(2)	(3)	(4)	(5)
l.ROA	0.881***	0.782***	0.875***	0.888***	0.813***
	(0.0711)	(0.0671)	(0.0668)	(0.0689)	(0.0771)
DLLP	0.716***	0.665***	0.629***	0.747***	0.649***
	(0.0572)	(0.0591)	(0.0810)	(0.0616)	(0.0665)
CRP	0.0996**				
	(0.0455)				
CEC		0.0513***			
		(0.0197)			
CEP			0.0666**		
			(0.0313)		
JI				0.0419***	
				(0.0103)	
ROP					0.0571
					(0.0412)
SARS	0.0667***	0.0699***	0.0518*	0.0713*	0.0567**
	(0.0234)	(0.0118)	(0.0301)	(0.0397)	(0.0257)
PR	-0.0527***	0.0267	0.0226	-0.0614***	-0.0599***
	(0.0193)	(0.0185)	(0.0195)	(0.0205)	(0.0119)
BSIZE	0.0991***	0.0876**	0.0981***	0.1021***	0.0784**
	(0.0336)	(0.0425)	(0.0347)	(0.0418)	(0.0332)
F_COM_TA	0.0124***	0.0365***	0.0311***	0.0393***	0.0542**
	(0.0016)	(0.0103)	(0.0109)	(0.0126)	(0.0256)
CAR	0.0312**	0.0346***	0.0345	0.0216**	0.0416***
	(0.0151)	(0.0105)	(0.0211)	(0.0103)	(0.0108)
lnCONCENT	0.097***	0.0734**	0.0631***	0.0709***	0.0691***
	(0.0344)	(0.0330)	(0.0217)	(0.0215)	(0.0222)
lnGDP	0.0422***	- 0.0598***	0.0397***	0.0425***	0.0418***
	(0.0102)	(0.0109)	(0.0102)	(0.0109)	(0.0119)
Constant	0.0127	0.0188	0.0261**	0.0478**	0.0422***
	(0.0226)	(0.0203)	(0.0102)	(0.0188)	(0.0152)
Observations	421	419	416	415	419
No. of instruments	41	41	41	38	41
AR1 (p-value)	0.1512	0.1244	0.1270	0.1123	0.1242
AR2 (p-value)	0.3164	0.4108	0.4124	0.4417	0.5169
Hansen-J (p-value)	0.5535	0.5194	0.6721	0.6613	0.6116

*Note: *** p<0.01, ** p<0.05, * p<0.1.* ROA represents Return on Assets, l.ROA represents the lag of return on Assets, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, SARS represents strength of Auditing and reporting standards, PR represent political rights, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnCONCENT represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

Our hypothesis that "EM has a positive effect on performance of banks*"* is confirmed by our results in Tables 15, 16 and 17. In the regression results, DLLP mostly has a positive influence on bank performance. As pointed out earlier, the average values of the institutional structures like SARS and contracting institutions reveal strong commitment to improve institutional structures that ameliorate expropriation of stakeholders and therefore leads to a situation where EM have a positive influence on performance. The possible intuition behind these results is that banks engage in earnings management to signal financial stability, smoothening earnings over time and demonstrate strength to stakeholders. This signalling helps reduce information asymmetry between bank managers and external stakeholders. As a consequence, the bank will attract more deposits at lower costs, access capital markets more efficiently, build stronger relationships with regulators and subsequently enhance performance. This finding is in line with the arguments of Bouaziz et al. (2020) as well as Mahrani and Soewarno (2018). This finding also algins with the positive accounting theory that points out that managers can employ earnings management to improve firm performance (Watts & Zimmerman, 1978). Lasty, the empirical results support the efficiency argument of Deegan (2009), which explains that rather than being an opportunistic tool, EM can be a strategy to enhance performance in such a way that will fulfil the interest of managers and all stakeholders.

Again, from the results in Table 16, we do find that SARS and the contracting institutions mostly have a positive effect on bank performance. This shows the valuable role of institutional structures in enhancing bank performance. However, the influence of these institutional structure on bank

performance cannot be completely interpreted without considering their role in the earnings management-bank performance nexus. Therefore, we contend that if there were a negative interaction term between DLLP and an institutional framework, then DLLP's impact on bank performance would be less pronounced the stronger the institutional structure. On the other hand, a positive interaction term between DLLP and an institutional framework would suggest that DLLP's impact on bank performance increases with the strength of the institutional structure. Table 16 displays the findings on the moderating influence of SARS on the link between EM and bank performance.

Table 16: Regression results on the moderating role of SARS in the relationship between earnings management and performance of banks in SSA

Dependent Variable: ROA

	(1)	(2)	(3)	(4)	(5)
l.ROA	0.889***	0.993***	0.926***	0.904***	0.886***
	(0.0922)	(0.0775)	(0.0817)	(0.0994)	(0.0666)
DLLP	0.719***	0.692***	0.887***	0.917***	0.778***
	(0.0779)	(0.0796)	(0.0778)	(0.0896)	(0.0669)
SARS	0.0513**	0.0772***	0.0669**	0.0701***	0.0994***
	(0.0249)	(0.0242)	(0.0313)	(0.0215)	(0.0226)
DLLP*SARS	0.0954**	0.0844**	0.0724**	0.0846**	0.0775***
	(0.0425)	(0.0416)	(0.0356)	(0.0401)	(0.0299)
CRP	0.106***				
	(0.0311)				
CEC		0.0779***			
		(0.0218)			
CEP			0.0586**		
			(0.0237)		
JI				0.0347***	
				(0.0117)	
ROP					-0.0571
					(0.0433)
PR	-0.0229***	-0.0269***	-0.0314**	-0.0513**	0.0428***
	(0.0081)	(0.0098)	(0.0128)	(0.0211)	(0.0100)
BSIZE	0.0683***	0.0682***	0.0871**	-0.0337	0.0718**
	(0.0111)	(0.0127)	(0.0361)	(0.0124)	(0.0306)
F_COM_TA	0.0313***	0.0296*	0.0442**	0.0397***	0.0423*
	(0.0098)	(0.0182)	(0.0199)	(0.0122)	(0.0221)
CAR	0.0315***	0.0347***	0.0417***	0.0316**	0.0319***
	(0.0104)	(0.0127)	(0.0105)	(0.0126)	(0.0117)
lnCONCENT	0.1181***	0.1862***	0.1564***	0.1719***	0.2718***
	(0.0199)	(0.0222)	(0.0316)	(0.0324)	(0.0414)
lnGDP	0.5151***	0.3522***	0.2976***	0.3435***	0.3162***
	(0.0326)	(0.0389)	(0.05491)	(0.0494)	(0.03219)
Constant	0.118	0.178**	0.162**	0.167*	0.1662**
	(0.181)	(0.0913)	(0.0718)	(0.0991)	(0.0693)
Observations	421	419	416	415	419
No. of instruments	41	41	41	38	41
AR1 (p-value)	0.0371	0.0347	0.0319	0.0398	0.0489
AR2 (p-value)	0.3162	0.3155	0.3502	0.2413	0.1129
Hansen-J (p-value)	0.4312	0.5601	0.6716	0.5673	0.6167

*Note: *** p<0.01, ** p<0.05, * p<0.1.* ROA represents Return on Assets, l.ROA represents the lag of return on Assets, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, SARS represents strength of Auditing and reporting standards, PR represent political rights, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnCONCENT represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

From the results in Table 16, it can be observed that the coefficient of the interaction terms between DLLP and SARS in all the models is positive. This means that in economies where there is high commitment to improving the SARS, these standards can constrain the opportunistic outcomes of earnings management, resulting in efficiency outcomes of earnings management and eventually improve bank performance. Another possible interpretation for these results is that strong auditing and reporting standards can affect stakeholder perception of reporting quality positively, increase corporate reputation, reduce regulatory sanctions and increase bank performance subsequently. This finding confirms our hypothesis that "SARS positively moderates the EM-performance relationship". Finally, this finding is in line with the New Institutional Theory which argue for the role of institutional structures in constraining behaviour of economic agents and achieving efficient outcomes.

The role of contracting institutions in the relationship between EM and bank performance

Table 17 presents the findings of the interaction terms between the contracting institutions' moderating impact in the link between EM and bank performance.

Table 17: Regression results on the role of contracting institutions in the relationship between earnings management and performance of banks in SSA

Dependent Variable: ROA

	(1)	(2)	(3)	(4)	(5)
l.ROA	0.899***	0.881***	0.835***	0.891***	0.921***
	(0.0924)	(0.0884)	(0.0671)	(0.0765)	(0.0673)
DLLP	0.771 ***	0.793***	0.701***	0.775***	0.705***
	(0.0333)	(0.0662)	(0.0771)	(0.0667)	(0.0567)
CRP	0.108**				
	(0.0525)				
DLLP*CRP	0.0216*				
	(0.0123)				
CEC		0.0493***			
		(0.0179)			
DLLP*CEC		0.0244**			
		(0.0121)			
CEP			0.0674***		
			(0.0227)		
DLLP*CEP			0.0419***		
			(0.0111)		
JI				0.0422***	
				(0.0099)	
DLLP*JI				0.0363***	
				(0.0135)	
ROP					0.0373
					(0.0279)
DLLP*ROP					0.0194**
					(0.0092)
SARS	0.0669***	0.0674***	0.0547**	0.0748***	0.0499**
	(0.0114)	(0.0182)	(0.0228)	(0.0226)	(0.0211)
PR	-0.0412***	-0.0366***	-0.0772**	0.0539	0.0648**
	(0.0196)	(0.0151)	(0.0143)	(0.0227)	(0.0215)
BSIZE	0.0882***	0.0852***	0.0692***	0.0616*	0.0717***
	(0.0219)	(0.0321)	(0.0218)	(0.0316)	(0.0221)
F_COM_TA	0.0721***	0.0644***	0.0593***	0.0778***	0.0873**
	(0.0283)	(0.0234)	(0.0212)	(0.0121)	(0.0406)
CAR	0.0556***	0.0542***	0.0464***	0.0592**	0.0616**
	(0.0119)	(0.0131)	(0.0132)	(0.0221)	(0.0300)
lnCONCENT	0.146***	0.112***	0.189***	0.122***	0164***
	(0.0224)	(0.0314)	(0.0311)	(0.0267)	(0.0369)
lnGDP	0.622***	0.657***	0.636**	0.498***	0.649**
	(0.0449)	(0.0247)	(0.0333)	(0.0341)	(0.0261)
Constant	0.117***	0.0993***	0.0762**	0.0812***	0.0746***
	(0.0284)	(0.0306)	(0.0314)	(0.0266)	(0.0212)
Observations	421	419	416	415	419
No. of instruments	38	42	38	40	42
AR1 (p-value)	0.0672	0.0882	0.0644	0.0713	0.0822
AR2 (p-value)	0.2265	0.2517	0.3526	0.4718	0.2522
Hansen-J (p-value)	0.6329	0.5112	0.5461	0.4531	0.5610

*Note: *** p<0.01, ** p<0.05, * p<0.1.* ROA represents Return on Assets, l.ROA represents the lag of return on Assets, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, SARS represents strength of Auditing and reporting standards, PR represent political rights, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnCONCENT represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

It is evident from Table 17's results that, in all models, the interaction terms' coefficient between DLLP and contracting institutions is primarily positive. These empirical results show that strong contract enforcement mechanisms can deter managers from expropriating stakeholders, reducing the opportunistic effects of EM and rather enhance bank performance. Specifically, in column 1 of Table 6, the interaction term between DLLP and CRP is positive and statistically significant. This could mean that in an economy characterized by strong creditor right protection, creditors are able to enforce their rights, thereby limit bank managers ability to manipulate earnings for opportunistic reasons, and eventually lead to efficiency gains in terms of bank performance. This finding corroborates the arguments of Ashraf and Zheng (2015).

In columns 2 and 3 of Table 17, we do find a positive and statistically significant interactions term between DLLP and less contract cost as well as DLLP and low number of procedures in enforcing contracts. This could imply that a legal system that is characterized with lower cost and fewer procedures of contract enforcement can incentivize banks' stakeholders to demand accountability and transparency in firms' reporting practices and eventually achieve efficient outcomes in earnings management by ensuring increase in bank performance. This result supports the arguments of Habib, Ranasinghe, Wu, Biswas and Ahmad (2022).

In columns 4 of Table 17, we do find a positive and statistically significant interactions term between DLLP and judicial independence. Since judicial independence strengthens the rights of bank stakeholders, including the right to demand accountability from bank managers (*see* Jensen and

Meckling, 1976), it reduces the opportunistic motives of earnings management and rather improves bank performance. Finally, in column 5 of Table 6, the interaction term between DLLP and reliability of police is positive and statistically significant as well. This result shows the invaluable role played by the policing system in reducing opportunistic EM motives of banks, as they form part of the overall legal architecture of an economy. In summary, our research indicates that the presence of stronger contracting institutions tends to increase the favourable impact of EM on bank performance. This supports our hypothesis that "Contracting institutions positively moderates the EM-performance relationship of banks."

On the control variables, political rights mostly have a negative effect of bank performance in all the regression results. This is in line with our earlier argument that since political rights in developing economies is relatively weak, there is weak transparency in the relationship between banks and government authority (Trueman & Titman, 1988), which makes highly politically connected banks usually have high return on assets (see Nega Lakew & Adeleye, 2020). Once the political institutions are strengthened, they will negatively affect bank performance. All of the regression results support our prior claim that bank size generally has a beneficial impact on bank performance. This means that large banks are able to leverage on economies of scale, incur relatively lower cost and increase their performance. The majority of the regression findings for capital adequacy showed positive coefficients, indicating that high capital adequacy ratios permit high-return lending, which in turn improves bank performance (Tan & Floros, 2013). Next, fees and commission income mostly had a positive effect on bank

performance and shows that new revenue streams improve bank performance (*see* Ashyari & Rokhim, 2020). The results on banking sector concentration shows that high concentration implies low competition, and this enhances bank performance. This is consistent with the arguments made by Allen and Gale (2005) on competition-fragility and competition-stability. Lastly, the GDP statistics indicate that bank performance rises in prosperous economic times.

Robustness check

A robustness assessment is carried out to address any concerns that the bank performance measurement may not be sufficient. To evaluate the sensitivity of the findings, we use a different bank performance measure. We use return on equity as a substitute performance measure. The idea behind this is that return on equity (ROE) indicates how profitable equity holders' investments were. To the extent that managers are able to hyperbolize the firm's earning to attract more investors, earnings management could affect returns on equity investment. Overall, the results reported in Appendix A, B and C of this chapter are similar to those obtained in Table 4,5 and 6 respectively. This means that our regression results are robust to an alternative measure of bank performance and biased towards the bank performance measure employed in the main analysis.

Summary and Conclusions

In this study, we highlighted the direct role of earnings management, strength of auditing and reporting standards as well as contracting institutions in enhancing bank performance. This study also demonstrated the conditions under which such the earnings management-bank performance relationship

may be altered by examining the role of SARS as well as contracting institutions in the relationship. By employing several measures of contracting institutions, the study mostly found that contracting institutions positively moderates the relationship. The study also reveals that the association is positively moderated by SARS. These demonstrate the critical role that robust reporting and auditing standards, together with contracting institutions, play in enhancing the link between bank performance and earnings management. In line with this, strengthening contracting institutions as well as auding and reporting standards is very vital in reducing the opportunistic motives of earnings management among banks and rather improves its efficiency gains in terms of enhancing bank performance.

APPENDICES TO CHAPTER SIX

Appendix A: Regression results on the relationship among earnings management, SARS, contracting institutions and performance of banks in SSA

Dependent Variable: ROE

	(1)	(2)	(3)	(4)	(5)
l.ROE	0.612***	0.881***	0.722***	0.799***	0.899***
	(0.0321)	(0.0573)	(0.0461)	(0.0512)	(0.0664)
DLLP	0.666***	0.566***	0.469***	0.447***	0.447***
	(0.0401)	(0.0349)	(0.0336)	(0.0413)	(0.0222)
CRP	0.0564**				
	(0.0225)				
CEC		0.0491***			
		(0.0171)			
CEP			0.0337**		
			(0.0101)		
JI				0.0622***	
				(0.0231)	
ROP					0.0443***
					(0.0112)
SARS	0.0776**	0.0444***	0.0618***	0.0663**	0.0657***
	(0.0321)	(0.0158)	(0.0222)	(0.0271)	(0.0199)
PR	-0.0433***	-0.0369**	-0.0367***	-0.0419*	-0.0411***
	(0.0103)	(0.0158)	(0.0115)	(0.0215)	(0.0123)
BSIZE	0.0437	0.0461	0.0519**	0.0772**	0.0594***
	(0.0306)	(0.0425)	(0.0225)	(0.0332)	(0.0221)
F_COM_TA	0.0414***	0.0668***	0.0511***	0.0442***	0.0437**
	(0.0102)	(0.0209)	(0.0231)	(0.0351)	(0.0216)
CAR	0.0443**	0.0677***	0.0733**	0.0398***	0.0556*
	(0.0197)	(0.0225)	(0.0317)	(0.0135)	(0.0312)
lnCONCENT	-0.0519**	0.0610***	0.0511**	0.0559**	0.0556***
	(0.0244)	(0.0221)	(0.0211)	(0.0207)	(0.0212)
lnGDP	0.0818***	0.0991***	0.0979***	0.0924***	0.0817***
	(0.0303)	(0.0396)	(0.0332)	(0.0309)	(0.0391)
Constant	0.0447	0.0308***	0.0316**	0.0228**	0.0223
	(0.0321)	(0.0109)	(0.0155)	(0.0101)	(0.0194)
Observations	443	439	436	436	439
No. of instruments	40	40	40	39	40
AR1 (p-value)	0.1656	0.1478	0.1755	0.1669	0.1472
AR2 (p-value)	0.3334	0.3119	0.3412	0.3191	0.3398
Hansen-J (p-value)	0.4552	0.4425	0.4472	0.4567	0.4441

*** *p<0.01*, ** *p<0.05*, * *p<0.1*. ROE represents Return on Equity, l.ROE represents the lag of return on Equity, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, SARS represents strength of Auditing and reporting standards, PR represent political rights, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnCONCENT represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

Appendix B: Regression results on the moderating role of SARS in the relationship between earnings management and performance of banks in SSA

Dependent Variable: ROE

	(1)	(2)	(3)	(4)	(5)
l.ROE	0.689***	0.887***	0.892***	0.884***	0.886***
	(0.0678)	(0.0664)	(0.0674)	(0.0869)	(0.0777)
DLLP	0.701***	0.772***	0.767***	0.777***	0.676***
	(0.0567)	(0.0516)	(0.0618)	(0.0716)	(0.0549)
SARS	0.0737**	0.0662**	0.0779**	0.0699**	0.0599***
	(0.0319)	(0.0332)	(0.0231)	(0.0301)	(0.0126)
DLLP*SARS	0.0516***	0.0564***	0.0467***	0.0566**	0.0577***
	(0.0123)	(0.0267)	(0.0152)	(0.0256)	(0.0209)
CRP	0.0926**				
	(0.0419)				
CEC		0.0919***			
		(0.0325)			
CEP			0.0761**		
			(0.0332)		
JI				0.0811**	
				(0.0335)	
ROP					0.0443*
					(0.0238)
PR	-0.0339***	-0.0419***	-0.0556**	-0.0433***	-0.0339***
	(0.0094)	(0.0074)	(0.0229)	(0.0101)	(0.0103)
BSIZE	0.0556***	0.0558***	0.0675**	0.0557***	0.0585***
	(0.0201)	(0.0210)	(0.0221)	(0.0104)	(0.0156)
F_COM_TA	0.0443***	0.0446***	0.0525***	0.0447***	0.0537***
	(0.0124)	(0.0102)	(0.0109)	(0.0112)	(0.0201)
CAR	0.0555***	0.0641***	0.0551**	0.0226	0.0597**
	(0.0147)	(0.0229)	(0.0215)	(0.0199)	(0.0237)
lnCONCENT	0.1333***	0.1652***	-0.2601***	0.3740***	0.3480***
	(0.0212)	(0.0342)	(0.0667)	(0.0411)	(0.0679)
lnGDP	0.4433***	0.6519***	0.3106***	0.4145***	0.5569***
	(0.0446)	(0.0331)	(0.07116)	(0.0414)	(0.03421)
Constant	0.111	0.109	0.162*	0.102	0.1551*
	(0.0881)	(0.0673)	(0.0908)	(0.0991)	(0.0922)
Observations	431	439	436	435	439
No. of instruments	40	40	40	40	40
AR1 (p-value)	0.0551	0.0557	0.0509	0.06591	0.0819
AR2 (p-value)	0.4214	0.4013	0.4552	0.2203	0.2229
Hansen-J (p-value)	0.5512	0.6709	0.5119	0.5553	0.6627

*** *p<0.01*, ** *p<0.05*, * *p<0.1*. ROE represents Return on Equity, l.ROE represents the lag of return on Equity, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, SARS represents strength of Auditing and reporting standards, PR represent political rights, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnCONCENT represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

Appendix C: Regression results on the role of contracting institutions in the relationship between earnings management and performance of banks in SSA

Dependent Variable: ROE

	(1)	(2)	(3)	(4)	(5)
l.ROE	0.669***	0.901***	0.857***	0.796***	0.891***
	(0.0444)	(0.0982)	(0.0573)	(0.0566)	(0.0553)
DLLP	0.710 ***	0.669***	0.607***	0.577***	0.509***
	(0.0552)	(0.0568)	(0.0611)	(0.0552)	(0.0336)
CRP	0.599**				
	(0.0414)				
DLLP*CRP	0.0336***				
	(0.0103)				
CEC		0.0499**			
		(0.0219)			
DLLP*CEC		0.0343***			
		(0.0111)			
CEP			0.0515*		
			(0.0312)		
DLLP*CEP			0.0224**		
			(0.0100)		
JI				0.0562*	
				(0.0299)	
DLLP*JI				0.0446***	
				(0.0112)	
ROP					0.0443***
					(0.0133)
DLLP*ROP					0.0155*
					(0.0096)
SARS	0.0556**	0.0577***	0.0466**	0.0664***	0.0611**
	(0.0223)	(0.0203)	(0.0199)	(0.0161)	(0.0256)
PR	-0.0662***	-0.0446**	0.0562***	-0.0499**	0.0558***
	(0.0226)	(0.0211)	(0.0213)	(0.0210)	(0.0200)
BSIZE	0.0552***	0.0772***	0.0592***	0.0516*	0.0667***
	(0.0118)	(0.0234)	(0.0128)	(0.0116)	(0.0121)
F_COM_TA	0.0491**	0.0566***	0.0663**	0.0667***	0.0659*
	(0.0201)	(0.0193)	(0.0332)	(0.0212)	(0.0346)
CAR	0.0442**	0.0442**	0.0545**	0.0616***	0.0556**
	(0.0221)	(0.0210)	(0.0227)	(0.0219)	(0.0231)
lnCONCENT	0.0916***	0.0982***	0.0899***	0.0992***	0.0966***
	(0.0335)	(0.0232)	(0.0216)	(0.0199)	(0.0221)
lnGDP	0.633***	0.335***	0.233***	0.339***	0.416***
	(0.0445)	(0.0441)	(0.0613)	(0.0448)	(0.0676)
Constant	0.0937**	0.0678	0.0662	0.0772**	0.0861**
	(0.0414)	(0.0462)	(0.0489)	(0.0346)	(0.0344)
Observations	431	439	436	435	439
No. of instruments	41	40	42	41	40
AR1 (p-value)	0.0512	0.0715	0.0824	0.0145	0.0272
AR2 (p-value)	0.3301	0.3573	0.3416	0.3318	0.3421
Hansen-J (p-value)	0.5319	0.5267	0.4491	0.4667	0.6190

*** *p<0.01*, ** *p<0.05*, * *p<0.1*. ROE represents Return on Equity, l.ROE represents the lag of return on Equity, DLLP represents discretionary loan loss provision, CRP represents creditor right protection, CEC represents cost of enforcing contracts, CEP represent the number of contract enforcement procedures, JI represents Judicial Independence, ROP represents reliability of police, SARS represents strength of Auditing and reporting standards, PR represent political rights, CAR represents capital adequacy ratio, F_COM_TA represents fees and commission income scaled by total assets, lnCONCENT represents the natural log of banking sector concentration. lnGDP represents the natural log of Gross Domestic Product.

CHAPTER SEVEN

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

This chapter presents a summary of the three empirical chapters on the relationship among earnings management, strength of auditing and reporting standards, contracting institutions and banks' performance in SSA. The chapter presents the key findings, conclusions on the hypotheses set from the beginning, the practical implications, contribution to theory and empirics, policy recommendation and recommendation for further study.

Summary of Key Findings

This thesis examines the relationships among earnings management, SARS, contracting institutions and SSA banks' performance. The research objectives of the study were:

1. To analyse the relationship between SARSs and Earnings Management of Banks of in sub-Saharan Africa
2. To assess the relationships among Contracting Institutions, Political Institutions and Earnings Management of Banks in Africa.
3. To investigate the role of SARS as well as Contracting Institutions in the r earnings management and banks' performance connection in sub-Saharan Africa.

To achieve the three research objectives, the thesis presented three main themes in the form of empirical chapters. A summary of the three empirical chapters is presented in the ensuing paragraphs:

Auditing and reporting standards represent important institutional factors that are important in limiting opportunistic behaviour of management

and are therefore required to reduce earnings management of banks. This study uncovered the influence of the SARS on earnings management of banks in SSA. As a further analysis, the study sought to examine whether accounting tradition, as measured by legal origin, moderate the relationship between SARS and earning management of banks. The SGMM estimates reveals that strengthening auditing and reporting standards reduces earnings management behaviour of banks in SSA. Additionally, the data demonstrate that in nations with a common law accounting past as opposed to a civil law one, there is a higher negative correlation between SARS and earnings management. This shows the role of stronger accounting tradition in reducing earnings management behaviour.

Also, this thesis sought to understand the role of contracting institutions in reducing earnings management of banks in SSA economies. By looking at the function that political institutions play in the connection, the empirical investigation in this respect showed the circumstances under which such a relationship may be changed. The analysis employed several measures of contracting institutions and found that contracting institutions reduce earnings management behaviour of banks. Further, the study showed that the negative relationship between contracting institutions and earnings management is more profound in economies with stronger political institutions than economies with weak political institutions. This also shows the role of stronger political rights in reducing earnings management behaviour.

In third empirical chapter, the study examined the direct role of earnings management, strength of auditing and reporting standards as well as contracting institutions in enhancing bank performance. This chapter

demonstrated the conditions under which the earnings management-bank performance relationship may be altered by examining the role of strength of auditing and reporting standards as well as contracting institutions in the relationship. By employing several measures of contracting institutions, the study mostly found that contracting institutions positively moderates the relationship. Also, the study finds that SARS positively moderates the relationship.

Conclusion on the Hypotheses and Practical Implication

The table below presents the conclusion on the research hypotheses set from the beginning as well as the practical implications of the conclusion on the hypotheses.

Research Objective	Research Hypothesis	Decision	Practical Implications
1. To analyse the relationship between Strength of Auditing and Reporting standards and Earnings Management of Banks of in sub-Saharan Africa	H_1: Generally, banks in economies with strong auditing and reporting standards are less likely to practice high level of earnings management.	Accepted	These findings suggest in an economy where there is compliance to auditing and reporting standards, earnings management behaviour of bank managers is likely to be minimized. Also, the results point out the critical role of auditing standards compliance as a complement to accounting standards in reducing the extent of managerial discretion of banks financial reporting.
	H_2: Legal origin significantly moderates the relationship between SARs and earning management of banks in sub-	Accepted	SARS better reduces earnings management behaviour of banks in sampled SSA economies with common law legal origin as compared to economies with civil law legal origin. This is

		Saharan African economies.		because SARS is likely to be more effective in common-law origin economies than civil law countries who are usually characterized by relatively poor accounting quality.
2.	To assess the relationships among Contracting Institutions, Political Institutions and Earnings Management of Banks in sub-saharan Africa.	H_1: Strong Creditor Right Protection has a negative influence on earnings management behaviour of banks	Accepted	This finding is not surprising because in an economy characterized by strong creditor right protection, creditors are able to enforce their rights and limit bank managers ability to manipulate earnings. In a similar vein, our results also suggests that when banks themselves are able to enforce seizure of collateral, there will be less need to manage loan provision.
		H_{2a}: Lower contract enforcement cost significantly reduces earnings management of banks.	Accepted	In a legal system that is characterized with less cost and procedures of contract enforcements can incentivize banks' stakeholders to demanding accountability and transparency in firms' reporting practices. In such circumstances, managers are less likely to less likely to engage in earnings management behaviour.
		H_{2b}: Lower contract enforcement procedures significantly reduce earnings management of banks.		
		H3: Judicial independence reduces earnings management of banks.	Accepted	Judicial independence strengthens the rights of bank stakeholders, including the right to demand accountability from bank managers, and therefore reduces the extent of earnings

			management behaviour of banks.
		H4: A reliable police system reduces the extent of earnings management of banks.	Accepted	A reliable police system can facilitate investigations and possible prosecution when necessary, and therefore poses a great caution to bank managers who may likely engage in earnings management.
		H5a. Strong political stability has a negative effect on earnings management of banks.	Accepted	There will be lesser incentive for banks managers to engage in earnings management in an economy that is politically stable because earnings and cashflows tend to be very stable in such environments.
		H5b. Political rights have a negative effect on earnings management of banks.	Rejected	It could imply that in economy that has strong political rights, bank managers could be confronted with intense pressure to maximize earnings, thereby leading to earnings management behaviour.
		H6: Political institutions significantly moderate the relationship between contracting institutions and earnings management of banks.	Accepted	In a strong political institution's regime, the relevance of contracting institutions is strongly projected by the high level of public scrutiny, stable cashflows and intense media. Therefore, incidences of bank earnings management are likely to be low.
3.	To investigate the role of Strength of Auditing and Reporting standards as well as	H1: EM has a positive effect on performance of banks.	Accepted	Within the context of strong commitment to improving institutional structures, managers can employ earnings management to signal high bank performance

Contracting Institutions in the relationship between earnings management and performance of banks in sub-Saharan Africa			without attracting negative consequences such as poor corporate reputation, loss of public confidence, regulatory sanctions and eventually poor bank performance.
	H2: Strength of Auditing and Reporting Standards positively moderates the Earnings Management-bank performance relationship	Accepted	In economies where there is high commitment to improving the SARS, ARS can constrain the opportunistic outcomes of earnings management, resulting in efficiency outcomes of earnings management and eventually improve bank performance.
	H3: Contracting institutions positively moderates the Earnings Management - performance relationship of banks.	Accepted	The positive influence of earnings management on the performance of banks tends the higher in the presence of stronger contracting institutions.

Contribution to Theory and Empirics

By analysing the relationship between Strength of Auditing and Reporting standards and Earnings Management of Banks of in sub-Saharan Africa, this study makes contribution to the both the agency and stakeholder theories. In line with the Agency theory, when shareholders enforce adherence to auditing and reporting standards, it reduces the agency problem between them and bank managers by ensuring transparency in reporting practices. From the perspective of stakeholder theory, strong adherence to reporting and

auditing standards is a way that other stakeholders of banks could assure themselves of high level of transparency and accountability in bank's reporting practices.

As far as we are aware, this is the first study to examine how banks' level of earnings management may change if they comply with Auditing and Reporting standards. Previous studies on Africa like Amidu and Issahaku (2019) have only examined how IFRS adoption but not compliance affects earnings management of banks in Africa. In this regard, this study provides new insights because IFRS adoption in an economy may not imply that Auditing and Reporting standards are strong in that economy (Adela et al., 2022).

The second objective assessed the relationships among Contracting Institutions, Political Institutions and Earnings Management of Banks in Africa. The second objective adds to the body of empirical data supporting the New Institutional Theory and the growing body of research on the connection between accounting outcomes and institutional structures. A vast amount empirical literature that anchors on the New Institutional Theory have examined how institutional structures affect finance outcomes. Notwithstanding, there have been recent attempts made in the accounting literature to employ the new institutional theory. Adela et al. (2022), for example, investigate the impact of alternative institutional frameworks on the robustness of ARS. By extending the arguments of the New Institutional Theory, this study distinguishes between institutions that ensure and support private contracts and institutions that reduce government expropriation (Acemoglu & Johnson, 2005). This thesis is therefore the primary one to

examine the connection contracting institutions has with earnings management of banks. This study distinguishes itself from other studies that have examined the relationships between other institutional structures and earnings management of banks.

The third objective examined how contracting institutions, auditing sand reporting standards' strength affected the link between sub-Saharan African banks' earnings management and performance. There are several ways in which analysing the link between bank earnings management and performance advances the positive accounting theory. Banks per their operations are different from conventional firms and therefore to provide a nuance understanding of the relationship, the study provides the first evidence in the context of banks in SSA economies. Again, the empirical evidence points out to efficiencies in earnings management behaviour of banks that leads to increase in their performance. Empirically, this study distinguished itself from that of Boachie and Mensah (2023) that examine the relationship between EM practices and performance of non-financial firms in SSA economies.

The study offers the first evidence on how SARS and contracting institutions make earnings management more effective in achieving bank outcomes like performance by examining the role of strength of auditing and reporting standards as well as contracting institutions on the relationship between earnings management and SSA banks' performance.

Policy Recommendations

Stakeholders and policy practitioners may notice that strengthening auditing and reporting standards as well as contracting institutions can be a

potent tool to reduce the opportunistic earnings management behaviour of bank managers. Therefore, finding from this study offers some pointers for formulation of policy. Overall, given that earnings management better enhances bank performance in the presence of strong auditing standards, reporting standards and contracting institutions, the effort by stakeholders and regulators in strengthening these institutional structures should not be underestimated. The specific recommendations based on the detailed findings are highlighted in the following paragraphs

Further commitment to improve the strength of auding and reporting standards

Recent evidence suggests that the adoption of IFRS in most SSA economies is mainly mandatory and allows for a small amount of discretion. Also, the quality of the compliance with reporting standards in SSA economies largely depends on auditing standards (Adela et al., 2022). Even though IFRS makes impairment rules stricter for banks and thus reduces the amount of discretion in loan loss provision, adherence to auditing standards could improve the efficacy of this role of IFRS. This has implications for economies as well as banks in SSA that have not adopted and complied to IFRS and IAS's.

Compliance to auditing and reporting standards would provide benefits such as reduction in the opportunistic outcomes of earnings management, reduce information asymmetry and improve bank performance. From the study findings, this recommendation is much more important to economies that have civil law legal origin as they are usually characterized by weaker protective accounting frameworks. These recommendations could also be

beneficial to banking sector regulators that require transparent and accurate information to aid in their monitoring duties. Finally, the recommendations are also important to bank that wish to reduce the extent of information asymmetry between bank managers and stakeholders in order to boost stakeholder confidence and improve bank performance.

Strengthening of contacting institutions

The results on the impact of contracting institutions on earnings management and their involvement in strengthening the connection between bank performance and earnings management in SSA economies has significant policy implications. Governments and policy practitioners may implement the following recommendations:

- Ensure that proper safeguards are instituted to strengthen the protection of creditor rights, such as strengthening laws on creditor right protection
- Make efforts to reduce the amount of legal procedures in enforcing contracts as well as the cost involved in those legal procedures
- Make the judiciary more independent in the discharge of their duties, such as making sure that there is separation of powers in the arms in government
- Equip the police service with the necessary logistics and compensation packages to make them more reliable in the discharge of their duties.

Strengthening of Political institutions

The findings that political institutions influence earnings management, and its efficiency is quite vital to all stakeholders that base key decisions on financial reports. Therefore, governments in SSA economies should make decisions that foster transparency, democracy and stability.

Suggestions For Further Studies

Given the moderating impacts of SARS and contracting institutions, the intricate link between EM and bank performance in SSA Africa presents a number of exciting study opportunities. These recommendations for additional study are meant to fill in existing knowledge gaps and deepen our comprehension of these significant connections. Using more advanced methodological techniques might greatly enhance future study. To better handle endogeneity issues, researchers may think about utilizing sophisticated econometric methods like other instrumental variables approaches like the 2SLSIV. Utilizing machine learning approaches may also yield fresh perspectives on earnings management trends and how they relate to bank performance. Comparative study across many settings and geographies has a lot of room. Future research should look at how SSA varies from other developing markets or established countries in terms of the link between earnings management and bank performance. Comparative studies of this kind may shed light on how institutional growth and market maturity influence these connections.

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