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Income smoothing and performances of enterprises: A study of manufacturing firms in Nigeria

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Abstract

The study examined income smoothing and performance of enterprises: A study of manufacturing firms in Nigeria. The objective is to determine whether income smoothing has relationship with performance of businesses taking a study of manufacturing firms in Nigeria. Using purposively sampling, technique data for five years (2017-2021) on Market Value Per Share (MVPS), Earnings Per Share (EPS), Net Assets Value Per Share (MVPS), Earnings Per Share (EPS), Net and Income (NI) were obtained from the annual reports of selected 20 manufacturing firms quoted on Nigerian Stock Exchange (NSE) as at 31st December, 2021. The analysis of the data was done using correlation and regression methods. Further, F-test statistics was done to compare variance obtained from the grouped sample. It was found that relationship exist between income smoothing and performance of manufacturing business, it was also found that firms in the high sales bracket presents less variable income numbers in their financial statements implying smoothed income than those manufacturing enterprises in the low sales bracket. The study recommends engagement of qualified and skilled auditors to investors for proper analysis of financial statements of enterprises for identification of smoothed income in the financial statements which in some cases are done fraudulently.

1. Introduction

One of the key benefits of accrual based accounting system of International Financial Reporting Standards (IFRS) is its application of accounting principles that allow estimates and personal judgments in financial reporting. The application of the accounting system helps users of financial information in assessing the economic performance of an entity during a period. With the use of estimates and personal judgment, management can apply control over records of transactions and prepare reports based on their taste and choice (Mooren and Harnby, 2016). The taste and choice of management in financial report preparation are usually made in order to reduce fluctuations in earning from one period to another as a way of managing expectations. The management of expectations involves moving revenues and expenses from one accounting period to another with management intention to level fluctuations in net income from different reporting periods purposely to attract investors (Leonard & Allen, 2017). Income leveling or smoothing is a means to woo investors and they (investors) are usually willing to pay a premium for stocks with steady and predictable earnings streams as opposed to stocks of companies with unstable and volatile earnings pattern. A company that shows consistent returns from year to year is likely to attract more investments as the investors will be comfortable seeing steady returns on their investments (Lawrel & Patrick, 2018). Investment is key in micro and macro economic growth and volatility in earnings of enterprises is a deterient to this growth variable as such, companies, engage in income smoothing especially under the IFRS reporting regime to attract investors (Richard & Ocleam, 2016).

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