



Trend Analysis in Real Earnings Management and its Effect on Financial Statements: A Case of Nigerian Financial Institutions

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Abstract

A well designed and implemented international financial reporting standard is expected to build confidence on credibility of quality of financial statements to investors and other stakeholders. The purpose of this paper is to understand the trends of real earnings management and its effect on financial statements in Nigerian financial institutions. Secondary data are sourced from the financial statements of the sampled financial institutions at the Nigerian Stock Exchange Market. The trend in real earnings management needs to identify the causes for any significant changes in the sector. The dependent variables; abnormal cash flow from operation, discretionary expense and cost of sale are utilized as a measure of real earnings management and the study sampled of 45 financial institutions, using descriptive analysis to analyzed the trend for the period of 2018 – 2023. The findings also revealed an increasing trend of real earnings management during research period. The study concluded that stakeholders including the investors, financial analysts and regulators would examine behavior of corporate manager thorough analyzing the comparative earning management trends of various time. The study recommended that, Regulatory bodies (CBN, NDIC, and SEC) should empower audit committee to challenge corporate managers on operational decisions that appear to prioritize short-term targets over long-term value.

Keywords: *Real earnings management, trend of real earnings management, financial institutions.*

1. Introduction

Regulatory authorities, corporate investors and other financial users have been paying more attention to the issue of financial scandals as well as deterioration of financial reporting quality following the many corporate scandals of giant companies in the world e.g., TD Bank at United States of America, and Evergrande Group at People's Republic of China, (Adejumo & Ogburie, 2025; Chakraborty, 2025; Negesh, 2025). Accordingly, Ogunleti, and Ajayi (2025) mentioned complex reasons that lead corporate

managers to participate in earnings management which is intricately intertwined with the interaction of diverse internal and external factors such as the desire to improve and increase the value of the information provided to the users of financial statements and pursuit the benefits enshrined in management contract.

Corporate managers search any gaps for conducting earnings management although regulatory agencies and accounting professional bodies have issued rules to



prevent or minimize such myopic behavior of corporate managers. One of the proofs that show the corporate managers' attempts to keep doing earnings management is by introducing new techniques which are difficult to identify (Shi., et al., 2022 and Cohen et al., 2008). Zang (2007) proves that managers use accrual earnings management and real earnings management interchangeably and Cohen et al. (2008) find that corporate managers replace accrual earnings management techniques with the real earnings management after the period of the Sarbanes-Oxley Act (SOX).

Shi, et al. (2022) find evidence that corporate managers in the United States prefer the real earnings management than accrual earnings management practices, with the aim to meet certain earnings targets. A tendency to choose the real earnings management practices is due to the accounting fraud conducted by the Enron Company detected and some regulations of SOX. The Sarbanes-Oxley Act regulation indeed gives a huge influence on earnings management practices in the United States, as described by Henry Paulson, the former finance minister of the United States. One of the main objectives of the SOX regulations is to restrain the earnings management practices and accounting fraud which lead to improve the integrity of the financial statements. Other developing economy like Indonesia and Nigeria especially financial institutions have no comprehensive rule yet such as SOX, with anticipation to restrain practice of earnings management. Despite the fact that, there is no incentive for corporate managers to change their approach in managing earnings target but earning management practice is still wide open to perform especially real earnings management (Aggelopoulos, et al., 2025; Attia et al., 2024).

More so, real earnings management portrays as the achievement of business dealings to influence reported earnings through selling goods under unfavorable conditions, with the plan of increasing revenue and overproduction to reduce the cost of sales (Roychowdhury, 2006). In the financial institutions specifically banking sector, corporate managers usually employ non-interest income activities to manipulate earnings. Non-interest income is generated from activities not related to lending and bank deposit. In fact, a low interest rate or low rate of return gives confidence banks and some other financial institutions to engage in non-interest activities to generate additional revenue and compensate margin shortfalls. Corporate managers can utilize the unbalanced nature of banks' non-interest revenue to manage the level of reported earnings in their financial statements in each period. Therefore, a change in non-interest revenue, which forms a large component of bank revenue, is a helpful on real earnings management activities. Cash flow is one of the most important components and the second main source of revenue for financial institutions which is utilized by management to manipulate earnings. The corporate managers can exercise control by accelerating the receipt of cash flow and providing discount to customers to make payment in order to manipulate earnings for their parochial interest (Ben Rejeb et al., 2025; Bansal, 2024).

In addition, current global and African trend indicate that Nigeria is the most populous country in Africa with estimates of 240 million citizens in 2025 (United Nation, 2025). It is ranked as the 49th to 52nd largest economy in the world regarding nominal GDP (IMF, 2025). Furthermore, Nigerian economy has enjoyed economic growth for years with an annual real GDP increased from 3.38% to 3.40% in 2024 and also increased from



3.40% to 3.98% in 2025 (CBN, report, 2025) and the economy is diversifying and becoming more services-oriented particularly through information and technology, banking and insurance services (African Development). Financial institutions in Nigeria act as the lifeblood of the economy. As of 2025, the sector has moved beyond traditional banking to become a high tech engine that drives nearly 20% of the country growth which impact on funding 96% of all businesses (SMEs) and handling trillions of Naira transactions. (Aribaba, et al., 2025).

In the Nigerian financial institutions, corporate managers tend to deviate from the essential elements of corporate principles of integrity and honesty, mutual respect and dedication to the firm for their parochial interest (Donaldy, & Massoudi, 2025; Gwobin, et al., 2025; Abubakar et al., 2017). Similarly, recent reports suggest three main causes for earnings management in financial institutions in Nigeria which include recapitalization pressure with 2026 deadline for banks to hit N500 billion for international licenses which lead corporate managers to revealed high incentive to show strong profitability to attract investors for right issues, the devaluation of the naira in 2024 to 2025 created massive FX Gains, as the results, Regulators are watching for creative accounting where these gains are used to cover operational losses (Abdulmumin, & Adeoti, 2025; Ngbede, et al., 2025) And lastly, institutional ownership call for higher transparency on the targeted earnings because they are professional investors which lead to pressure management to manipulate earnings in order to protects their interest (Ogunleti & Ajayi, 2025; Davidson, 2024).

Real earnings management has been used in numerous empirical studies (Musa, et al., 2025; Tanko, 2025; Salihi, et al, 2024) to show trends over time in line with the objective of standard setters to evaluate

changes in financial accounting standards as well as making comparison with a view to protect shareholders' wealth and other relevant stakeholders' interest. Other issue of earnings management trend include, determining the effect of REM on the keeping pace with the recent changes in auditing as well as corporate governance in general (Oreshile & Adeneye, 2025; Kumari & Pattern, 2015).

Based on research conducted by previous scholars (Aggelopoulos, et al., 2025; Gwobin, et al., 2025; Ogunleti & Ajayi, 2025; Attia et al., 2024; Cohen et al., 2008), it was interesting to test trend of REM in Nigerian financial institutions which may explore the clear trend of REM. And also understand actual scheme of REM practice in Nigeria. Therefore, the research questions on whether the trend of REM is increasing during the period or not. The aim of this research is to provide empirical evidence of trend analysis of REM in Nigerian financial institutions for the period of 2018 to 2023.

2. Literature Review

2.1 Earnings Management

It is difficult to discover a universally acceptable definition of earnings management. However, several scholars have provided various explanation of the concept. For example, Barnea, Ronen, and Sadan (1976) perceive earnings management as a deliberate dampening of fluctuations about some level of earnings considered being normal for the firm. Habib et al, (2022) explain that earnings management is any effort to tamper with the financial reporting process to internally change its true picture of the economic performance of a company. Wahlen (1999) quote that earnings management occurs when corporate managers use its judgment in financial reporting and structuring transaction to manipulate the financial reports either to mislead shareholders and other stakeholders about the true economic



picture of the company or to influence contractual outcomes that depend on accounting figures.

Bansal (2024) postulate earnings management as the deliberate manipulation of financial statements or business operations by management to achieve specific financial outcomes, meets predetermined targets, or influences the perception of stakeholders regarding the company's economic health. Therefore, the earnings management method used for such ends can be categories in terms of whether they affect the process of accrual-based accounting or real activities, Accrual-based EM (AEM) using the flexibility of accounting rules (GAAP/IFRS) to change the timing of revenue or expense recognition without changing cash flow. REM Influencing earnings by changing actual business activities, which directly impacts cash flow and can harm long-term value for instance cutting research and development budgets at year-end or over producing inventory to lower unit costs which may increase profit of the current year.

Cohen and Zarowin (2010) view earnings management as intentional actions engages by corporate managers to deviate from normal business practice in order to meet financial reporting benchmarks or to avoid reporting annual losses. Roychowdhury (2006) define REM as a departure from normal operational activities motivated by corporate managers' desire to mislead a segment of stakeholders in believing some aspect of financial reports in routine operation. In essence, corporate managers manipulate operational activities to meet their short terms goals which may not add value to the firm in future.

The above definitions contain a number of issues. From the accrual-based and real activities perspective, management uses judgment in selecting accounting methods for reporting the same economic transactions. All choices in accounting

methods (for instance, depreciation method, inventory valuation on or old-balance among others) affect the financial reporting but REM is more harmful on the financial statements of the firm. Indeed, the general objective of earnings management is to mislead stakeholders through the use of AEM and REM.

2.2 Empirical review of earnings management

The literature suggests increase of EM can deteriorate the confidence of stakeholders on financial information of organization. Degree of EM may lead investors, regulatory agencies and other stakeholders to be skeptical of the credibility of financial statement (Lee, & Masulis, 2011; Myers, et al., 2007). Furthermore, several empirical studies examines the effect of EM on financial reporting, for example, Salawu et al., (2024) evaluate the effect of directors compensation on EM practices within Nigerian banking sector. The study used adjusted population of eleven (11) listed commercial banks and employed census sampling method to analyze data. Directors compensation was measured using a combination of executive and non-executive directors (NEDs) compensation while, discretionary provision for loan loss (DPLLS) as a proxy of EM practices. Authors considered Beaver and Engel (1996) model and Ordinary least square (OLS) regression to analyze the data of the study. The findings revealed that NEDs with fees and allowances have significant effect on EM practices of commercial banks in Nigeria. The study recommended that regulatory agency (CBN) should provide policy that considers the totality of NEDs compensation instead to emphasized on only chairman compensation. And also, to provide guideline for mandatory disclosure of directors' compensation in the financial statements. Noted that, this study cannot be generalized because of the limitation of considering only banks without other financial institutions. Salihi,



et al. (2024) studied the relationship between sustainable development triangle and REM, the moderating role of business innovation. The study measured corporate social responsibility with quadruple bottom line approach and used Roychowdhury model (2006) to identify the practice of REM. Authors used Panel data for 740 firm year observations from non financial listed companies in Nigerian stock exchange. The result revealed that business innovation strengthen the significant relationship between economic, environmental, social, governance and REM, noted that the study focus on non financial listed companies which restricts to generalizes the finding.

Bui (2024) examining the Scopus database of publications from 1993 to 2021 to improve our understanding of earnings management which demonstrate remarkable growth in earnings management research, with 54% of publications emerging from 2016 to 2021, peaking at 226 papers in 2021. Active contributors to earnings management research are from the US, China, UK, and Australia. In addition, this paper discussed four distinct themes within earnings management, including the motives and characteristics of earnings management activities, real and accrual-based earnings management, the relationship between corporate governance and earnings management, and earnings management and market performance. More importantly, the study's findings provide insights to develop the research on earnings management, especially in the emerging market finance context. Gavana (2025) identify the academic contexts where the research on earnings management in family firms is developed, as well as its past and recent trends, gaps and directions for future research. This study carries out a bibliometric and systematic literature review on a sample of 252 papers from the Scopus and Web of

Science Core Collection databases. This study provides a systematic overview of the characteristics of the research groups engaged in studies on earnings management in family firms. Finding showed that family ownership, corporate governance, board independence, audit committee and corporate social responsibility are relevant topics in earnings management studies on family companies, although the extent of research addressing each theme varies. A multi-theory theoretical framework, the focus on a broader range of stakeholders, a more detailed analysis of family firms' heterogeneity and increasing attention to real earnings manipulations emerge as recent trends. And also, it points out past and recent trends and literature gaps and, on this basis, suggests various directions for future research.

Oreshile, and Adeneye (2025) explored the relationship between real earnings management (REM) and financial performance (FP) and examine the moderating effect of the whistle blowing policy (WBP) on the REM-FP relationship. It further investigates the potential channels through which REM deters FP. This study empirically tests whether the perceptual deterrence theory is relevant to the ongoing debates and variations in the relationship between real earnings management practices and financial performance. The authors utilize a panel data set of publicly quoted non-financial companies operating in twelve (12) sub-Saharan African countries from 2014 to 2020. It employs the disclosure of WBP in the corporate governance section of annual reports to gauge WBP, while REM is estimated using aggregated real earnings components (abnormal production costs, abnormal discretionary expenditures, and abnormal cash inflows). The study discovered that REM reduces FP. Findings also indicate that WBP mitigates the adverse impacts of REM on FP. This study



further empirically documents that agency costs, CEO integrity, and financial distress are potential channels through which REM negatively impacts FP.

Bansal (2024) undertakes an extensive and systematic review of the literature review on earnings management over the past three decades from 1992 to 2022. A comprehensive collection of 2,775 articles on EM published from SCOPUS database, the study employed various tools such as Microsoft Excel, R studio, Gephi and visualization of similarities viewer, to conduct bibliometric, contents, thematic, and cluster analyses. The study discovered three major themes which include operationazation of EM constructs, the tradeoff between EM tools (AEM, REM, and classification shifting) and the role of corporate governance of mitigating EM in emerging economy. Existing literature in this area presents mixed and inconclusive results. Furthermore, the study observed shift in research focus over time, understanding manipulation technique, evaluating regulatory measures and impact of global accounting standards. In addition, the offer significant insight in to sophisticated techniques of EM, such as neutral networks, machine learning technique, hidden Markov models as well as relevant theories which include dynamic capabilities theory, learning curve theory, psychological contract theory, normative institutional theory. These techniques and theories demonstrate the need for further research in the field of EM.

2.3 Agency Theory

Agency theory is derived from the economic theory which was promulgated by Alchian and Demsetz (1972) and further enhanced by Jensen and Meckling (1976). An agency relationship is defined as the relationship between the principals (owners of a firm) and their agent (corporate managers) (Hussain, & Akbar, 2022). While as observed by Jensen and Meckling (1976) agency relationship

portrays some form of contract whereby one or more parties (principal) involve another party (agent) to carry out some service on their behalf that incorporates delegation of decision-making responsibilities to their agents. The authors suggest that if the agency agreement is utilized and maximised by both parties, there is enough reason for believing that their agent possibly always act in the greatest interests of the owner.

Zhao and Shi (2024) states that agency theory is aimed at solving two problems that exist in the agency relationship. Firstly, problems that can come up due to a clash of interest involving the principal and the agent. Secondly, problem that can arise when it is difficult or costly to know what the corporate manager is actually doing. These two problems will no doubt lead to the principal incurring additional monitoring cost and bonding cost generally known as agency cost. "The principal can limit divergences from his interest by establishing an appropriate incentive for the agent and by incurring monitoring costs designed to limit the unusual activities of the agent" (Panda & Leep, 2017).

Corporate managers are responsible for managing the operation of business and preparing a financial report of the company at the end of the period. Consequently, they are often incentivized to meet or exceed earnings targets through performance related bonuses. Given the authority granted to these managers and the inherent information asymmetry, managers may exercise their discretion over accruals to overstate earnings (Baskaran, et al., 2020). This reduces the reliability of the financial statements. As a result of managerial discretions and information asymmetry, it will be hard for shareholders to trust managers. Hence, the shareholders need to put in place structure and control mechanisms to reduce the gap that exists by putting their reprehensive on the board and creating the committee to verify the



reliability of the financial statement (Ali, et al., 2022). According to Fama and Jensen (1983), the committee helps to diminish effectively the agency cost caused by separating ownership from control.

Agency theory posits that the contractual agreement between the principal (owner) and the agent (corporate manager) generates information asymmetry. Both parties wish for maximize their utility. Shareholders expect enormous returns, while corporate managers seek to optimize their income. This situation requires the involvement of a third party (regulatory agencies) to regulate this conflicting relationship (Jensen & Meckling, 1976). Therefore, the purpose of regulatory agencies is to protect the interests of both parties. It works to prevent managers from becoming entrenched or earning abnormally high incomes. One of its most important responsibilities is to prevent corporate managers and other stakeholders from manipulating financial statement of a firm (Hussain, & Akbar, 2022). Therefore, the research methodology would provide appropriate approach to be clear trend of real earnings management activities.

3. Methodology

3.1 Sample and Data Collection

The population of this study consist of all Nigerian financial institutions (e.g. Banks, Insurance, Micro finance and other financial service firms) listed on the Nigerian stock exchange (NSE). The justification for choosing financial institutions to the best of the researcher's knowledge is based on the fact that the firms are vulnerable to management manipulations due to high operating activities associated with their transactions (Habib, et al, 2022). Any firm that has been listed or delisted after December 2017 or firm with missing data was excluded from the sample size of the study. The study arrived at 270 firm-year observations for the year 2018 to 2023. Unit of Analysis

was 45 listed financial institutions (270 firm-year observations). Secondary data on REM were collected from the audited financial statements of the financial institutions.

3.2 Data Analysis Technique

The study utilizes Descriptive Statistics of Trend Analysis to interpret the data from 2018 to 2023. The justification for using a Year-on-Year (YoY) Mean Comparison in this study of Nigerian financial institutions is rooted in its ability to detect systematic shifts in behavior across the entire sector (Quest, et al., 2025). Trend Identification for the annual mean is used to track the movement of REM.

3.3 Real Earnings Management Model

This study uses real earnings management approach to measure EM. Real earnings manipulation are perpetrated through a wide range of EM techniques available to corporate managers in preparing financial reports such as, increase of discount or lenient credit terms and declines of discretionary expenses (Oreshile, et al., 2025). Roychowdhury (2006) mentioned three components of identify real earnings manipulation which include (1) cash flow from operation (2) over production cost and (3) discretionary expense.

1. Cash flow from operation - when corporate manager increases offer of lenient credit term in order to increase sales for the target period.

$$CFO_{it}/A_{it-1} = \alpha_0 + \alpha_1 (1/A_{it-1}) + \beta_1 (S_t/A_{it-1}) + \beta_2 (\Delta S/A_{it-1}) + \varepsilon_{it}$$

2. Discretionary expense - corporate manager can reduce expenses at his discretion such as research and development expenses; selling, general and administrative expenses, advertisement expenses in order to increase current earnings.

$$DC_t/A_{it-1} = \alpha_0 + \alpha_1 (1/A_{it-1}) + \beta (S_{it-1}/A_{it-1}) + \varepsilon_{it}$$

3. Over production – corporate manager can accelerate production more than

necessary in order to decrease cost of goods sold. However, due to unavailable data on the production in the financial sector only cost of sale, cash flow from operation method and discretionary expense method are suitable for financial institutions.

$$ECOGS_{it}/ A_{it-1} = \alpha_0 + \alpha_1 (1/ A_{it-1}) + \beta (S_{it}/A_{it-1}) + \varepsilon_{it}$$

This study calculates the aggregate REM by summing the residual values of these three models. A higher residual value indicates a greater deviation from normal operations which is representing higher agency costs. The models include the following;

ABCFO = Abnormal cash flow from operation activities.

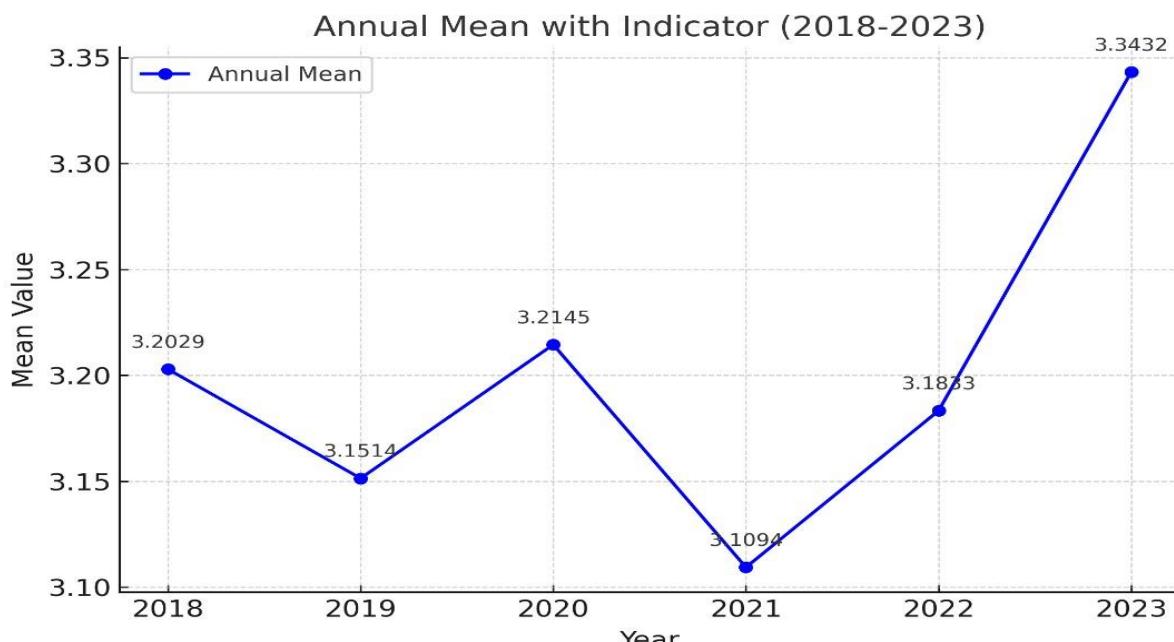
ABDCE = Abnormal discretionary expense

ABCGS = Abnormal cost of goods sold. Therefore, real earnings management formula is finally expressed as

$$REM = ABCFO + ABDCE + ABCGS$$

4. Result and Discussion

Figure 4.1 provides the trend results of the mean descriptive statistics for the study



Line Graph of Annual Mean of Real Earnings Management (REM)

variables regarding 270 firm-year observations of Nigerian financial institutions listed on NSE during the period 2018-2023. Regarding REM, its trend analysis from the period of 2018 to 2023 is also presented in Table 1.1; the mean value of REM for the year 2018 is 3.2029. This indicates the existence of REM in Nigerian financial institutions. However, there is a slide reduction of REM in the sampled financial institutions which stood to 3.1514 in the year 2019 compared to 2018. This might be attributed to the introduction of the new strategies to mitigate it by regulatory agencies like CBN and EFCC by identifying REM may lead to address the issue of accountability and transparency. In relation to the year 2020, there is a slide increase in REM as the figure rose from 3.1514 in the year 2019 to 3.2145 in the year 2020. This signifies upward movement of manipulation of business activities. The slide increase may occur as the result of negligence of overseeing function by CBN and NDIC to mitigate practices REM.

Figure 4.1

However, there is a slide decrease to 3.1094 in the year 2021 of real activities



manipulation. The drop to 3.1094 is generally a positive signal. It demonstrates that the firms' financial reporting became more transparent and accountable with less reliant on operational mechanism to hit profit goals. Besides, there is the slight increase in the REM in the year 2022 as the figure rose to 3.1833. The rise from the 2021 level to 3.1833 indicates an increase in operational manipulation. In accounting research, a higher REM score typically signifies that management has intensified its use of non-optimal business decisions to artificially inflate reported earnings. This trend suggests the firm is potentially sacrificing future profitability for present appearance which may lead the deterioration of confidence of investors and other users of financial statements.

Henceforth, the annual mean of REM for the year 2022 is greater than that of the year 2021, which indicates upward earnings manipulation for the period. In the same vein, the annual average of REM in 2023 is 3.3432 which are the highest of all. The rise to 3.3432 represents the highest level of REM across the analyzed period. This peak signifies that the company's reliance on operational activities to meet financial targets reached its maximum intensity in 2023. The justification of this increment in 2023 may be as the result of large volume of transactions which may give more chance to corporate managers to manipulate earnings in order to protect their personal interest.

Figure 4.1 also portrays that the trends of REM of the listed financial institutions in Nigeria for six years, from 2018 to 2023. Over the years, REM of the financial institutions in Nigeria has shown an unstable movement which needs to be justified. The reason for unbalanced REM because During the COVID-19 recovery phase, the Central Bank of Nigeria (CBN) introduced significant regulatory forbearance. Banks were allowed to restructure loans and were given more

flexibility in reporting, which reduced the need for corporate managers to cut discretionary expenses or manipulate cost of sales to hit profit targets. The 3.1094 figure reflects a period of higher earnings quality as the regulatory safety net reduced the incentive for manipulation.

2023 was a year of extreme economic shifts in Nigeria, including the Naira redesign policy, the removal of the fuel subsidy, and the unification of the exchange rate. The peak score of 3.3432 indicates that Nigerian financial institutions engaged in the highest level of real manipulation to navigate these shocks. The analysis shows a deteriorating trend in earnings quality from 2018 to 2023. While the banks and other financial institutions remained profitable, the high REM score in 2023 suggests that a significant portion of that profit was achieved through operational adjustments, manipulation of cost of sale and cost-cutting rather than purely organic growth.

5. Conclusion

This study examined the trends of Real Earnings Management (REM) in 45 Nigerian financial institutions from 2018 to 2023 through the lens of Agency Theory. Findings revealed that REM is a consistent feature in the Nigerian financial sector, with mean scores never falling below 3.1011. The trend exhibited instability, reaching its lowest point in 2021 (3.1094) due to regulatory forbearance during the COVID-19 recovery, and peaking at its highest point in 2023 (3.3432). The record high manipulation in 2023 suggests that corporate managers used aggressive operational adjustments such as manipulating cost of sales and cutting discretionary expenses to mask the shocks of the Naira redesign, subsidy removal, and exchange rate unification.

The upward trend in REM highlights a significant Agency Problem. Information



asymmetry allows corporate managers (agents) to prioritize personal gains such as performance based bonuses over the long-term interests of the shareholders (principals). By sacrificing future growth through cutting R&D and discretionary expenses, and cost of sales for present profit of the year.

The study concludes that the quality of financial reporting in Nigerian financial institutions is deteriorating. While firms appear profitable, this profit is increasingly altered through operational maneuvers rather than natural growth. This trend undermines the core objectives of IFRS, which seeks to ensure transparency and credibility. Without heightened oversight, the rising REM levels threaten to erode investor confidence and market stability. Based on the study's findings regarding the unbalanced trend of REM in Nigerian financial institutions, the recommendations; Regulatory bodies (CBN, NDIC, and SEC) should empower Audit Committee Oversight to challenge corporate managers on operational decisions that appear to prioritize short-term targets over long-term value. Stakeholders should advocate for compensation structures that discourage REM by linking bonuses to long-term sustainability rather than just annual net income.

Limitations of the Study; it provides significant insights into the REM trends of Nigerian financial institutions, The study focused exclusively on listed financial institutions on the Nigerian Stock Exchange (NSE). Therefore, the findings may not fully represent the behaviour of private or non-listed microfinance and primary mortgage institutions that operate under different regulatory authorities.

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