AUDIT CHARACTERISTICS AND EARNINGS MANAGEMENT IN NIGERIA: EVIDENCE FROM PUBLICLY LISTED INSURANCE FIRMS

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Abstract

This study examines the correlation between the earnings of a selection of firms listed on the Nigerian Exchange Group and the characteristics of auditors. The data originated from the audited annual reports and accounts of seventeen (17) insurance companies from 2014-2024, and an ex-post facto design was used. For the listed insurance firms, secondary data on the auditors' characteristics (audit fees, audit size and auditor independence score) and earnings management metric (proxied by discretionary accrual) were computed. The ordinary least square regression methodology was used to analyse the collected data and findings indicated a strong positive correlation between audit size and earnings management. Furthermore, a positive and robust relationship between auditor independence score, audit fees and earnings management was established. Based on the findings, the study recommends the need to increase auditors' independence so as to mitigate the negative effect of earnings management. Independence of the auditor should not be compromised in order to to produce high-quality financial reports free from earnings manipulation. Also, the study recommends against raising auditors' fees because it hinders their ability to demonstrate their professionalism and expertise and quickly undermines their audit function or role; this will help auditors reduce earnings management techniques because their reputation would be at risk due to jealousy's influence on their established reputation.

Keywords: Earnings management; Discretionary accrual; Audit fee, Audit tenure, Audit size; Nigeria

JEL Classification: M41, M49

1. Introduction

The role of the auditor in mitigating the negative effect of earnings management has been well documented in the accounting literature. To properly carry out the auditors' job, an auditor must possess a fair number of the qualitative qualities that will enable him to compete favourably in the corporate sector and strictly adhere to professional auditing standards (Khadijat, Onipe& Muhammed, 2024). Regardless of the auditor's contact with the clients - direct or indirect, internal or external, the auditor is deemed to maintain a very high level of independence to make sure that they do not compromise or deliver objective reports. According to Ombugu and Udeh (2023), auditors must therefore have both technical and functional attributes, such as professional competence, an ethical mindset, and educational backgrounds.

The aforementioned characteristics allow for the examination and evaluation of the financial statements that entities' management has given in order to create a judgement that the users of financial statements (stakeholders) will use to guide their decision-making. Abdullahi (2022) posits that audit professionals' disregard for ethical standards contributed to the audit collapse or failures that have place globally. Internal auditors for Worldcom and Enron abused their fame by concealing the reality of their companies' worsening financial status because they lacked professional integrity (Dabor, 2017). The reputation of audit service providers was horribly abused as a result of these self-interests (Manta, 2021).

Nigerian firms either collapsed or experienced audit catastrophes during that time, according to a 2009 report by the Central Bank of Nigeria (CBN). The external auditors' reports on the financial viability were unqualified. The audit collapse affected auditors, investors, and the general public as observed by Izevbekhai, Odion and Olowoyo (2022). Due to their enormous financial losses, the public's trust in the stock market suffered. The auditors lost their reputation and the public's trust since their reports were falsified to merely persuade stakeholders that companies were performing well (Yahaya & Awen, 2021).

Additionally, there is contradictory empirical data regarding the association between the qualities of auditors and earnings management; some studies have produced positive findings, while others have produced negative findings. In addition, researchers in Nigeria ignored the use of audit size and independence score variables. For example, Izevbekhai, Odion, and Olowoyo(2022) used the audit size as the only independent variable. However, Galal, Soliman, and Bekheit (2022) took audit size and independence into account as independent variables. The current study fills the research gap created by auditors' independence score exclusion.

Another study gap emanated from the duration of investigation. For instance, previous research spanned four years, from 2007 to 2023; these periods are somewhat outdated because a lot of things had happened. A good example is the revised Corporate Governance Code amendments issued by the Nigerian Securities and Exchange Commission. These changes have negatively affected the findings of the previously reported studies, rendering them unreliable.

Furthermore, our research focuses on publicly listed insurance firms between 2014 and 2024, whereas previous studies were either in the banking or conglomerate industries. This study closed these gaps and contributes to the corpus of current knowledge; given the foregoing, the following enquiries were investigated in this study: What effect does the size of an audit size have on managing earnings? What effect has the auditor independence score had on earnings management? What influence has the audit fee had on earnings management?

2. Review of Related Literature

2.1 Auditors' Characteristics

Audit quality is a measure of how much the public or the auditors' customers expect them to alert management of any errors, inconsistencies, or financial misstatements discovered in audited financial statements (Williamson & Akpomedaye, 2021). These characteristics could be technical or functional. While technical aspects are concerned with meeting the clients' expectations in reporting inherent errors and irregularities in financial statements to satisfy the user's needs, functional qualities concentrate on how audit process, procedure, methods, and audit empathy are geared towards meeting the clients' expectations (Yahaya & Onyabe, 2022)

First, an auditor's independence in reporting on audited financial statements includes any choices they make independently of others. When choosing the financial reporting process and the audit exercise, the auditor's mental acuity is involved (Izevbekhai et al, 2022). As noted by

Khadijat et al. (2024), an auditor must be impartial in their audit services and not be influenced, persuaded, or biased. Halim (2021) asserts that the high fee the client pays could jeopardise the auditor's independence because the client's economic bond fluctuates in tandem with the high fee.

The stock market suffers significant setbacks when audit quality is diminished as a result of a compromise in auditor independence (Abdul-Rahman, Benjamin & Olayinka, 2017). Serious questions concerning auditor independence were raised by the global audit failure. The dependability of public financial statements depends on auditor independence since it boosts investor trust in the financial statements and confirms their objectivity (Galal, Soliman & Bekheit, 2022).

A study by Onyabe et al. (2018) discovered a substantial positive correlation between earnings management and auditor independence; this may be due to the fact that the opinions of an independent auditor are more reliable, relevant, and objective, which makes earnings management more challenging. According to Yahaya and Awe's (2021) research, the biggest barrier to auditors' independence is the size of their audit fees. On the other hand, Yahaya and Onyabe (2022) noted that the audit and non-audit fees pose a danger to the independence of auditors.

2.2 Earnings Management

There are numerous meanings of "earnings management" in the accounting literature. The words "creative accounting," "income smoothening," and "accounting numbers game" are synonymous, according to Phillips, Pincus and Rego (2023). Managers that exercise restriction or lack thereof over accounting figures are involved in earnings management (Bouaziz, Fakhfakh & Jarboui, 2020). Care is taken to satisfy firm value of stakeholders or to serve the interests of the managers (Yuliza, 2018). These definitions presume that there is not a single, and widely accepted definition of earnings management because the term appears to be very broad.

The argument over what qualifies as generally acceptable earnings management is further supported both within and outside of generally accepted accounting principles (GAAP). Earnings management is unethical and against all other accepted accounting principles when it does not comply with GAAP, but it is lawful and acceptable to shareholders when it does (Halim, 2021). The latter assertion that earnings management include altering the financial statements by employing a variety of accounting estimates, methodologies, and judgements that deviate from GAAP in order to achieve objectives that do not accurately reflect the reporting entity's fundamental economic realities is supported by this study.

There are several reasons why managers are motivated to limit reported earnings. The literature identified several reasons for manipulating earnings around equity offerings, such as initial public offerings (IPOs) and seasoned equity offerings (SEO), as well as raising share prices, reaching performance-based compensation targets, and avoiding debt covenant violations (Akhalumen & Monday, 2019). Despite the fact that there are varied justifications for earnings management, they were categorised into four (4) main groups. These consist of contracts for management compensations, capital market incentives, loan agreements, and incentives pertaining to political and regulatory requirements (Robbetze, de-Villiers, & Harmse, 2017).

Over time, it has become more difficult to spot manipulations in the financial accounts that are made public. Many accounting models have been used to quantify earnings management. According to Williamson and Akpomedaye (2021), some authors substitute anomalous or discretionary accrual for earnings management. Several models have been developed, including the Jones model, industry model, DeAngelo model, Healey model, and modified Jones model. The most widely and acknowledged model in accounting empirical research for analysing earnings management is the modified Jones model (1995), which this study employed.

2.3 Theoretical Framework

This study uses the agency theory to explain the relationship between the characteristics of the auditors and earnings management. Agency theory was based on Berle and Means's (1932), as referenced in Bala et al. (2019). These scholars looked into the concept of agency and how it relates to business expansion. The researchers employed the concepts of agency and principal to explain the genesis of those conflicts by identifying the ways in which the interests of the firm's owners and directors diverge, leading to agency conflicts.

Agency theory was formalised by Jensen and Meckling (1976), who built on the work of Berle and Means (1932). There will always be some degree of goal conflict between parties because efficiency and effectiveness are inseparable. Consequently, there will always be some asymmetry in the information exchanged between the principal and the agent (Bouaziz et al., 2020). Thus, the core of agency theory is the contractual agreement between two or more people, referred to as the agent(s), to perform specific tasks on behalf of the principal (Galal et al., 2022).

Moreover, it is presumed that the agents and the principal made a mutual agreement or contract motivated solely by self-interest. The principal assigns decision-making authority to agents (Timea, 2019). It is a hypothesis that explains why people in a group exhibit various decisions or actions. It specifically describes how an agent and a principle interact when they delegate responsibilities to one another (Awa & Obinabo, 2020). Regardless of their individual objectives, it points out that the two parties usually have different goals and attitudes towards risk, which helps to explain why they act or make different decisions (Agwor & Onukogu, 2018).

Furthermore, it is always anticipated that both parties will be impacted by the agents' choices. These connections are evident in business and economic life and also result in more problems with contracts between economic organisations, according to Achraf, El-Ammari, and Bouri (2021). According to Williamson and Akpomedaye (2021), this suggests a contractual agreement between the auditors, the audit committee and shareholders, or the directors and shareholders.

3. Methodology

Ex-post facto research design using panel data is the methodology used in this study. The investigation's time frame, which was selected to achieve the study's objectives, was from 2014 to 2024. Nonetheless, the judgemental sampling technique was used to select seventeen (17) listed insurance firms on the floor of the Nigerian Exchange Group (NGX). The effect of auditor characteristics on earnings management was determined via multiple linear regression estimations.

The dependent variable was earnings management, as determined by discretionary accruals, whereas the independent variables were characteristics of the auditors (as determined by the natural logarithm of audit fees, audit size, and auditors' independence score). Data for the study were obtained and computed from the yearly audited and published financial statements of the selected insurance firms in Nigeria. The study's independent and dependent variables led to the estimation of the following empirical models:

$$Dac = f(Audfees, Audsize, Audsco) \quad 1$$

$$Dac_{it} = \beta_0 + \beta_1 Audfees_{it} + \beta_2 Audsize_{it} + \beta_3 Audsco_{it} + \varepsilon_{it} \quad 2$$

Where Audfees is audit fees, Audcco is the auditor independence score, Audsize is the audit firm size (measured using a dummy variable: 1 if audited by Big-4 Auditors, and zero otherwise), and Dac is discretionary accrual, a measure of earnings management. It is assumed that characteristics of auditors will have a significant effect on the level of earnings management. The statistical software STATA 13.0 was used to analyse the data.

Table 1: Descriptive Statistics

Parameters	Dac	Audfees	Audsize	Audsco
Mean Score	-0.0063	2.0174	0.4514	0.8274
Maximum Score	0.1115	2.4063	1.2038	0.4815
Minimum Score	-0.1180	1.3099	0.0000	1.1798
Standard Deviation Score	0.0548	0.2876	0.5869	0.1850
Skewness Score	0.0209	-0.6775	0.6215	-0.1348
Kurtosis Score	2.8986	2.9083	1.5248	2.4983

Source: Researcher's Computation (2025)

4. Empirical Results

Table 1 is the descriptive statistics of the dependent and independent variables of the study; it was observed that the independent variables (Audfees, Audsize, and Audsco) had positive mean scores as a result of improvements in financial reporting in the period examined except the dependent variable (Dac). The standard deviations score ranged from 0.0548 (Dac) and 0.5869(Audsize); however, the dependent and independent variables showed no zero skewness scores, Audfees was positively skewed while the variables had normal distribution, because the scores were close to three (3).

Table 2: Pearson Correlation

Parameters	Dac	Audfees	Audsize	Audsco
Dac	1.0000			
Audfees	-0.2331	1.0000		
Audsize	0.0241	-0.2102	1.0000	
Audsco	0.0441	-0.0239	0.0104	1.0000

Source: Researcher's Computation (2025)

Table 2 revealed that coefficient of auditors' characteristics (Audsizeand Audsco) were positive, suggesting that audit size and auditor independence score moved with discretionary accruals (Dac) in the same direction while Audfees was negative, indicating that it moved in the opposite direction with Dac. However the Pearson coefficients for all the variables did not go beyond the maximum benchmark of 0.8, indicating an absence of multicollinearity among pairs of the independent variables.

Table 3: Variance Inflation Factor Result

Parameters	VIF	1/VIF
Audfees	1.02	0.9803
Audsize	1.14	0.8771
Audsco	1.09	0.9174
Aggregate VIF	1.08	

Source: Researcher's Computation (2025)

Table revealed that the aggregate mean VIFis 1.08; this is not greater than the threshold aggregate mean VIF of 10.0. An indication of an absence of multicollinearity in models of auditors' characteristics (Audfees, Audsize, and Audsco) and earnings management (Dac).

Table 4: Ordinary Least Square (OLS) Result

F-Score	=	66.44		
Prob. > F:	=	0.0000		
R-squared:	=	0.8100		
Adjusted R-Squared	=	0.7100		
Dac	**Coefficient**	**Standard Error**	**t-score**	**t-probability**
Audfees	-0.0179	0.0414	-9.41	0.000
Audsize	-0.0884	0.0077	-6.62	0.000
Audsco	0.3213	0.0319	7.31	0.000
_Constant	0.0417	0.0522	9.08	0.000

Source: Researcher's Computation (2025)

Table 4 is the ordinary least square (OLS) result of auditor characteristics (Audfee, Audsize, and Audsco), and earnings management (Dac). The R-squared is 0.8100, indicating that auditors' characteristics explained 81 percent of the systematic variation in Dac; this suggests that there were few variables that may explain earnings management but not captured in the empirical model of the study. The coefficients of auditors' characteristics were statistically significant; this indicates that auditors' characteristics significantly influence the level of earnings management. Additionally, the F-score is 66.44 with a p-value of 0.000 which is less than 0.05 percent; this suggests that auditors' characteristics has significant effect on earnings management of the listed insurance companies in Nigeria.

5. Conclusion and Recommendation

The study's goal was to look at the connection between listed insurance companies' earnings management and the characteristics of their auditors. Given this, our results show that audit firm size significantly affects earnings management. Also, audit fees have a major effect on earnings management as well. Finally, the independence score of auditors and earnings management are positively correlated. Based on the findings and conclusions of the study, it was suggested that companies should endeavour to maintain or expand their operations to a sizeable level; this will enable them to monitor management's actions and create a strong governance framework and internal control system that will help them minimise or reduce earnings management practices.

Furthermore, as it has been found that preserving auditor independence considerably reduces earnings management, regulatory frameworks and organisations that supervise accounting and auditing practices in Nigeria should ensure that this is maintained. In order to avoid the familiarity danger, an auditor's job should also not last longer than three years. Failure to do so could compromise their independence and lead to poor financial reports. Based on the study's findings, we recommend against raising auditors' fees because it hinders their ability to demonstrate their professionalism and expertise and quickly undermines their audit function or role. This will help auditors reduce earnings management techniques because their reputation would be at risk due to jealousy's influence on their established reputation.

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