

## AUDIT QUALITY AND EARNING MANAGEMENT: EVIDENCE FROM DEPOSIT MONEY BANKS IN NIGERIA

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### ABSTRACT

*Despite regulatory efforts to reduce unethical financial reporting methods, financial misbehavior continues to occur in Nigeria's deposit money institutions. The purpose of this study is to examine the relationship between audit quality and earnings management in the country's quoted deposit money institutions. The study covers all ten quoted deposit money banks in Nigeria, with a sample size of nine banks. The hypotheses were tested using robust random effect regression models. The findings show that joint audit and audit fees have a strong favorable effect on the absolute discretionary accrual of quoted deposit money institutions in Nigeria. However, audit firm size and audit tenure exhibit insignificant positive effects on the discretionary accrual of deposit money banks in Nigeria. The study advocates for the increased engagement of non-big-four audit firms by deposit money banks in Nigeria for auditing their financial statements. This strategic shift is proposed to discourage manipulations of financial statements and reduce absolute discretionary accrual within these institutions. Furthermore, the study recommends that deposit money banks in Nigeria should discourage the simultaneous appointment of multiple auditing firms for audit assignments during the same accounting period, aiming to curtail absolute discretionary accrual within their operations.*

**Keywords:** Audit quality, earning management, joint audit, audit fee, audit tenure

### INTRODUCTION

Audit quality is synonymous with the effectiveness of an audit in providing accurate and reliable information about a company's financial statements. High audit quality signifies thorough, independent, and skillful auditors capable of discerning material misstatements or fraudulent activities, thereby offering stakeholders assurance in the trustworthiness of financial information. Regulatory bodies in Nigeria, including the Central Bank of Nigeria (CBN) and the Financial Reporting Council of Nigeria (FRCN), establish standards for financial reporting and auditing. A robust regulatory framework contributes to audit quality by imposing stringent standards on auditors and fostering transparency. The inverse relationship between audit quality and earnings management is well-known, as high audit quality discourages aggressive earnings management. Diligent and independent auditors are more likely to uncover attempts to alter financial statements, discouraging managers from participating in earnings management practices.

Unethical accounting methods can result in financial scandals and the bankruptcy of large organizations. Earnings manipulation, which falls under the larger area of earnings management, is a serious unethical issue in accounting. It is used by management as a strategic tool, purportedly to increase the firm's value and reduce risks. This includes distorting or manipulating the application of generally accepted accounting rules (GAAP) (Hussainin, 2014). Earnings management is defined as management's purposeful attempts to influence reported earnings by specialized accounting

processes, expediting spending or revenue transactions, or using other measures to alter short-term profitability. Essentially, it is a systematic distortion of a corporation's or other organization's actual income and assets. The practice happens when managers use their judgment in financial reporting, structuring deals to affect financial reports. This manipulation could be designed to deceive specific stakeholders about the company's true economic performance or to affect contractual outcomes based on reported accounting (Omoye & Eriki, 2014).

Audit firms serve as external validators of financial statements and play an important role in curbing earnings management practices. The size of the audit firm, whether it's a Big Four firm or a smaller regional one, can influence its ability to detect and prevent earnings management. Larger audit firms, such as the Big Four (Deloitte, PwC, EY, and KPMG), are often perceived to have greater resources, expertise, and reputation, which can lead to more effective detection and prevention of earnings management practices. The relationship between audit firm size and earnings management of deposit money banks in Nigeria is complex and may vary based on factors such as the specific audit firm's resources, expertise, and commitment to ethical practices. DeAngelo (1981) asserted that larger audit firms may have advantages in terms of resources and reputation, the effectiveness of their audits in curbing earnings management also depends on various other factors, including the regulatory environment and the banks' corporate governance practices.

Joint audits involve the participation of two or more audit firms in the examination of a company's financial statements. This approach is often used to enhance audit quality and reduce the risk of audit failures, particularly in cases of complex or large organizations like DMBs. Joint audits involve multiple audit firms, which can lead to increased oversight and scrutiny of financial reporting. This heightened attention could act as a deterrent to earnings management, as companies may be less likely to engage in manipulation when faced with the involvement of multiple audit firms. Different audit firms in a joint audit may bring diverse perspectives and approaches to the audit process. This can lead to a more thorough examination of financial statements, making it harder for management to manipulate earnings without being detected.

The relationship between audit fees and experience on earnings management in the context of deposit money banks in Nigeria is an important aspect to consider. Audit fees refer to the amount charged by audit firms for their services in reviewing a company's financial statements and internal controls. Experience, on the other hand, pertains to the level of proficiency and knowledge that auditors possess from previous engagements. Banks that pay higher audit fees may receive more rigorous and thorough audits. Experienced auditors with a deep understanding of the industry and the bank's operations are better equipped to identify potential instances of earnings management. They are more likely to scrutinize the financial statements and internal controls in greater detail, making it more challenging for the bank to engage in earnings management practices.

Audit tenure is the amount of time an audit firm has been serving a specific customer. Several studies have examined the potential impact of audit tenure on profits management, and the results have been varied. According to some studies, extended audit tenure may result in a more cooperative and trustworthy relationship between auditors and clients, thereby lowering the likelihood of aggressive earnings management. The rationale behind this argument is that auditors who have a longer history with a client are better positioned to detect irregularities and are more familiar with the client's operations, making it harder for management to manipulate earnings without being questioned. On the other hand, there are concerns that long audit tenure might lead to complacency or familiarity threats,

where auditors become too close to their clients and might overlook irregularities. Additionally, some research has proposed that shorter audit tenure could lead to a "honeymoon period" during which clients might be less likely to engage in aggressive earnings management to establish trust with the new auditors.

The importance of listed deposit money banks in Nigeria's financial system and economic stability motivates researchers to investigate the impact of audit quality on earnings management. Deposit money banks are important middlemen that collect public funds and allocate them to productive companies, so promoting economic growth and development. The accuracy and reliability of financial reporting within these banks are crucial for maintaining investor confidence, making informed investment decisions, and ensuring the overall health of the financial sector.

In the Nigerian banking sector, Deposit Money Banks (DMBs) play a pivotal role in facilitating economic growth and stability. However, concerns have arisen regarding the integrity of financial reporting practices within these institutions, particularly in relation to earnings management. Earnings management, characterized by deliberate manipulation of financial statements to portray a distorted image of a company's financial performance, can undermine transparency, investor confidence, and the overall health of the financial system. Audit firms serve as critical external monitors, entrusted with the responsibility of assessing the accuracy and fairness of financial statements. The size of an audit firm, often indicated by its resources, expertise, and reputation, could potentially influence the effectiveness of this oversight process. Despite this, the impact of audit firm size on earnings management within Nigerian DMBs remains an area with limited empirical investigation.

Simultaneously, the practice of joint audit, where two or more auditing firms collaborate to audit a single entity, has been implemented to enhance audit quality and transparency. However, there is a dearth of comprehensive research investigating the relationship between joint audit and earnings management in the context of Nigerian DMBs. Okolie *et al.* (2018) asserted that despite regulatory efforts to curb unethical financial reporting practices, instances of financial misconduct continue to emerge, raising questions about the effectiveness of joint audit as a safeguard against earnings management. On the flip side, coordinating the efforts of multiple audit firms can be complex. This could potentially create gaps in the audit process that might be exploited by management for earnings management purposes.

The financial crises and the collapse of several industries have prompted accounting regulators to scrutinize reporting practices and accounting standards more rigorously than ever before. These events have exerted significant pressure, leading to changes in the reporting of audit quality in financial statements within the country. The financial scandals have underscored the limitations of relying solely on the competence and independence of auditors to ensure audit quality. This realization has sparked a revolution in the design and evaluation of audit quality, necessitating comprehensive reinforcement to address the issue. The global concern for high-quality external audits has intensified, particularly after corporate scandals involving companies such as Enron, WorldCom, Global Crossing, Cendant, Sunbeam, Independent Insurance, Equitable Life, Lever Brothers, African Petroleum, Cadbury, and several failed banks in Nigeria, including Savanna Bank, All States Trust Bank, Assurance Banks of Nigeria, City Express Bank, Hallmark Bank, Metropolitan Bank, Liberty Bank, Eagle Bank, Republic Bank, Premier Bank, Intercontinental Bank, Cooperate Commercial Bank, Gulf Bank, Highland Bank, Lead Bank, Pan African Bank, Progress Bank, Trade Bank, and United Commercial Bank.

The widespread failures of banks and corporations around the world have generated serious concerns about audit quality and external auditor independence. Subpar audit reports issued by banks and enterprises have hampered Nigeria's ability to attract high-quality, long-term international investment. According to research, financial statement users' confidence has gradually eroded as a result of the poor quality of audit reports published in Nigeria (Enekwe et al., 2016). The incidence of audit errors worldwide, particularly in Nigeria, has left financial report readers severely dissatisfied. The cause of this problem has been related to audit firms' long tenures, which is frequently associated with creative accounting. In the Nigerian audit scene, the concerns of audit tenure and audit quality reporting have received little empirical attention beyond anecdotal evidence (Mgbame et al., 2012).

The question of auditor tenure has sparked heated debate: should a firm replace its auditors on a regular basis or enable auditors to form long-term relationships with clients? The creation of a high-quality audit report is seen as critical in creating trust among financial report readers. Investors, in particular, place more trust in audited financial statements because the perceived independence of auditors increases the confidence that substantial investment choices may be made based on these reports. The heightened confidence of these financial users tends to attract capital inflows, contributing to long-term growth and development in the business environment.

As such this study examined the effect of audit quality and earnings management of listed deposit money banks in Nigeria. The specific objectives of the study include: (i) To assess the effect of audit firm size on absolute discretionary accrual of deposit money banks in Nigeria, (ii) To examine the effect of joint audit on absolute discretionary accrual of deposit money banks in Nigeria, (iii) To determine the effect of audit fee on absolute discretionary accrual of deposit money banks in Nigeria, and (iv) To assess the effect of audit tenure on absolute discretionary accrual of deposit money banks in Nigeria. In line with the specific objectives of this study the following hypotheses are formulated in null form;

**Ho<sub>1</sub>:** Audit firm size has no significant impact on earnings management of listed deposit money banks in Nigeria.

**Ho<sub>2</sub>:** Joint audit has no significant impact on earnings management of listed deposit money banks in Nigeria.

**Ho<sub>3</sub>:** Audit fee has no significant effect on earnings management of listed deposit money banks in Nigeria.

**Ho<sub>4</sub>:** Audit tenure has no significant effect on earnings management of listed deposit money banks in Nigeria.

## REVIEW OF RELATED LITERATURE

### Concept of Audit Quality

According to Hope and Langli (2007), audit quality is defined as the auditor's ability to do work with greater independence and objectivity than usual. They also describe auditor independence as the auditor's neutrality and ability to resist client pressure, which includes both monetary and non-monetary reasons that may otherwise force the auditor to agree with management preferences rather than apply professional judgment. According to Wallace (1980), audit quality is a measure of an auditor's ability to reduce noise and improve accounting data correctness. According to Lee et al. (1999), audit quality is the possibility that an auditor would not issue an unqualified report for financial statements that contain errors, whether intentional or unintentional. Titman and Trueman (1986) use an alternative approach, defining audit quality as the accuracy of information reported by auditors. In this context, audit quality involves the auditor's competence in detecting a breach and their willingness to report such a breach, combining both auditor competence and independence. This study interprets audit quality as a state in

which the auditor is not influenced or controlled by the management of an entity through any means. It underscores the auditor's ability to impartially identify and report errors and misstatements in financial statements, including instances of earnings management.

### **Audit Firm Size**

Audit firm size is often used as a measure of audit quality, suggesting that larger firms, driven by the imperative to safeguard their reputation, are more likely to provide an unbiased and high-quality audit service. Larger audit firms benefit from greater financial resources, advanced research facilities, superior technology, and a highly skilled workforce, positioning them to effectively conduct audits for large companies compared to their smaller counterparts. Their extensive client portfolios enable them to resist management pressure, while smaller firms with limited client portfolios may be more susceptible to yielding to management demands (Mahdi & Ali, 2009). Consequently, the size of the audit firm emerges as a significant indicator of auditor independence, with the preservation of independence being particularly crucial for smaller firms when compared to their larger counterparts.

Numerous studies have explored the correlation between audit firm size and audit quality. Large audit firms are incentivized to conduct superior audits as they have a strong reputation to uphold and are averse to jeopardizing it. Additionally, they boast substantial material and human resources, allowing them to attract specialized and skilled personnel. Large audit firms, by virtue of their experience, generate higher revenue and mitigate their clients' exposure to legal action. The size of the audit firm emerges as a pivotal factor influencing the assessment of audit quality, with a positive relationship observed—larger audit firms consistently delivering better audit quality compared to their smaller counterparts.

### **Joint Audit**

Holm and Thinggaard (2009) evaluated the effect of joint audits on audit quality in the Danish setting. Their research concentrated on non-financial enterprises listed on the Copenhagen Stock Exchange (CSE) during the period of joint audit elimination. Despite examining anomalous accruals as a measure of audit quality, the findings yielded insignificant coefficients. This shows that, in the Danish context, joint audits do not appear to be more effective in regulating earnings management than individual audits.

Lesage et al. (2010) also explored the influence of joint audits on audit quality in Denmark. Their examination of abnormal accrual measures for different periods yielded similarly insignificant coefficients. These findings reinforce the notion that, as measured by abnormal accrual levels, joint audits do not significantly impact audit quality.

In a study done in Denmark, Zerni et al. (2012) studied the effects of voluntary joint audits on audit quality in Sweden between 2001 and 2007. Their sample comprised both publicly traded non-financial Swedish corporations and privately held firms. The findings showed that companies who chose voluntary joint audits had higher earnings conservatism, fewer aberrant accruals (both of which serve as proxies for audit quality), higher credit ratings, and lower risk projections of insolvency than other enterprises. These outcomes suggest that the decision to opt for joint audits might be influenced by minority shareholders seeking a higher degree of conservatism in the company's accounting decisions.

## **Audit Fee**

Several studies, such as those by DeAngelo (1981), Francis (2004), and Hay & Davis (2004), have utilized audit fees as a crucial factor in examining the correlation between audit quality and firm size. The payment of higher audit fees is often linked to the selection of qualified auditors (Hay & Davis, 2004). Interestingly, despite the higher costs associated with audit fees, certain clients prefer engaging with large audit firms. This preference is rooted in the confidence that larger audit firms provide enhanced monitoring and bonding mechanisms, ultimately resulting in superior audit quality (Hay & Davis, 2004).

Considering the competence and specialization of auditors, which encompasses technical knowledge and ongoing education, larger audit firms tend to attract and hire more skilled professionals compared to their smaller counterparts. Consequently, the size of the audit firm is directly proportional to the expected higher specialization of auditors (and consequently higher audit quality), leading to the justification of higher audit fees, as argued by DeAngelo (1981).

## **Audit Tenure**

Audit firm tenure refers to the duration during which an auditor provides services to a client. The risk of compromising independence tends to rise with prolonged client relationships. Some think, however, that sustaining a long and devoted association can increase independence. Auditor tenure is defined as the duration of the auditor-client relationship (Okolie 2015). A protracted tenure between the audit firm and its client may diminish the robustness of the audit process, leading to decreased vigilance and potential compromises on the auditor's part due to growing familiarity.

Furthermore, an extended engagement may lead to less diligence on the side of the auditor in finding internal control breaches and analyzing risk profiles. This is because the auditor's objectivity in spotting anomalies is strongest in the early years of the audit engagement but gradually fades over time, reaching its lowest point after several years of delivering audit services. In recent years, the number of years for auditor tenure in developed countries has decreased significantly. In the United States, auditor tenure has been reduced from seven to four years, whereas Europe advises a five-year engagement time. Two contradictory viewpoints exist about the implications of auditor tenure on audit quality. One perspective suggests that as the length of the auditor-client relationship increases, auditors may form a close bond with the client, potentially leading to a bias in favor of management and a decrease in audit quality. This viewpoint advocates for mandatory audit partner rotation. Conversely, the other viewpoint argues that with a longer auditor tenure, auditors enhance their understanding of the client's business and develop expertise over the course of the audit, ultimately resulting in higher professional consideration.

## **Earnings Management**

The primary objective of earnings management is to present earnings of sufficient quality that align with either shareholder expectations or the necessity to secure relevant authorization from regulatory bodies (Francis et al., 2008). Consequently, earnings management shares commonalities with earnings quality, encompassing accruals quality, earnings persistence, earnings predictability, and earnings smoothness. Watts and Zimmerman (1978) define earnings management as the extent to which managers exercise discretion over accounting numbers. They posit that earnings management occurs when managers engage in discretionary behaviors related to accounting figures, whether within or without prescribed limits, with the aim of maximizing the company's value. Another perspective on earnings management, offered by Healy and Wahlen (1999), asserts that it transpires when managers

exercise judgment or discretion over accounting numbers. The intention is to modify financial reports, either to mislead various stakeholders regarding the underlying financial or economic performance of the company or to influence the outcomes of contracts contingent on reported financial numbers or accounting practices.

As highlighted by Nelson et al. (2002), earnings management can be characterized as non-neutral financial reporting that is both illegal and unethical. Magrath and Weld (2002) define earnings management as the utilization of strategies by managers to fulfill stakeholder commitments or deceive investors. According to Roman (2009), earnings management takes place when the management of a firm seizes opportunities to make accounting decisions that alter reported income, thus capitalizing on these situations. He emphasizes that the accounting for business operations involves the exercise of judgment and involves making estimations, such as projecting income based on factors like the timing of customer payments, the number of non-paying customers, returns for refunds, and seller expenses for warranty or maintenance guarantees.

### **Theory Underpinning the Study**

#### **Agency Theory**

The agency theory formulated by Jensen and Meckling (1976) focuses on the dynamics between principals (shareholders) and agents (company managers). It deals with costs related to the relationship between the principal(s) (shareholders) and the principal(s) (management). This agency relationship is understood as a contract in which one or more individuals (principal(s)) use the services of another person (agent) to perform certain tasks on their behalf. In this agreement, the principal delegates certain powers to the agent, authorizing them to make decisions on behalf of the principal (the business owner). If the agent deviates from the principal's instructions during decision-making, the principal can mitigate the deviations by creating appropriate incentives for the agent and incurring control costs aimed at discouraging the agent's possible irregular activities (Aliyu et al., 2015).

Estitemi and Omwenga (2016) claim that because the principals do not have access to all available information at the time the agent takes decisions, they are unable to determine if the agent's decision is in the best interests of the company. To reduce moral hazard, principals choose to implement a monitoring procedure, such as auditing, to regulate the behavior of the agent(s) who make choices for the organization. Audits play a fundamental role in fostering confidence and building trust in financial information among users and the general public. Understanding the principal-agent relationship, as outlined in agency theory, is crucial in appreciating the auditor's role in generating high-quality reports for businesses. In this context, principals entrust agents to act in their best interests; however, information asymmetries can lead to diverse motives. Principals may lack trust in their agents and, as a result, may implement measures or mechanisms, such as audits, to reinforce trust. The agency theory, serving as an economic framework of accountability, is instrumental in explaining the evolution of audit quality in a broader context. The study is grounded in the agency theory, emphasizing the principal-agent relationship and the necessity for monitoring mechanisms like auditing to address agency conflicts. This theory highlights the significance of audits in aligning the interests of shareholders and management. Consequently, it provides a solid foundation for examining the impact of audit quality on earnings management in Nigerian deposit money banks.

## Empirical Review

Rashidat et al. (2022) undertook an investigation to assess the impact of audit characteristics on the financial reporting quality of twelve listed Depository Money Banks (DMBs) in Nigeria spanning the period 2012 to 2018. Employing a correlational research design, the study utilized pooled Ordinary Least Squares (OLS) regression for data analysis. Audit committee independence, audit committee expertise, and audit tenure were utilized as proxies for audit characteristics, while financial reporting quality, measured through discretionary accruals (DMBs), served as the dependent variable. Initially considering a population of fourteen listed DMBs, the adjusted population was narrowed down to twelve listed DMBs. Panel data extracted from financial reports were analyzed based on the Modified Jones model. The results derived from the regression analysis indicated that both audit committee independence and audit committee expertise exerted a positive and significant influence on the financial reporting quality of listed DMBs in Nigeria. These findings affirm the crucial role played by the independence and expertise of the audit committee in enhancing the quality of financial reports. In light of these results, the research recommends that regulatory authorities in the banking sector contemplate enforcing professional qualifications, as outlined by the Financial Reporting Council of Nigeria (FRCN) in the pending 2016 draft of the Nigerian Code of Corporate Governance (NCCG). This proposed measure aims to bolster the expertise and diligence of audit committees. Furthermore, the research advocates for concerted efforts to ensure that audit committee independence contributes to a faithful representation of financial reports, thereby preventing the dissemination of misleading information to global consumers of accounting data.

Aondoakaa and Achika (2022) conducted a study to explore the impact of audit quality on earnings management among listed industrial goods firms in Nigeria. Employing a correlational research approach, the study utilized secondary data collected from eight selected Nigerian industrial goods manufacturers over a ten-year period (2010-2019). Multiple regression analysis using Strata version 11 was performed on the data. The study revealed that the size of audit firms did not show a significant association with earnings management in listed industrial goods firms (IGFs) in Nigeria. Additionally, auditor sector specialization was not significantly linked to earnings management in listed IGFs, while auditor tenure demonstrated a significant impact on earnings management. Auditor client importance was also found to significantly affect earnings management in listed IGFs in Nigeria. In light of these findings, the study recommends that the size of audit firms should not be the sole criterion for selecting audit services. Furthermore, strict adherence to the Securities and Exchange Commission (SEC) recommendation that companies should not retain an audit firm for more than ten consecutive years is advised. To address the impact of audit fees on client importance, regulatory bodies such as the SEC and the Financial Reporting Council of Nigeria (FRCN) should mandate the disclosure of all audit fees as a mandatory requirement for all listed industrial goods firms in Nigeria.

Ada and Stella (2022) conducted an investigation into the influence of audit quality on earnings management within the domain of Deposit Money Banks in Nigeria. Employing a correlational research design, the study utilized the Ordinary Least Square (OLS) technique for the analysis of secondary data collected from a sample of 14 banks over a seven-year period (2013-2019). The study's findings indicated a significant positive impact of total audit fees on earnings management, and auditor tenure was also found to have a significant positive effect on earnings management. In light of these results, the study recommends heightened oversight by regulatory agencies on audit practices, particularly in the context of statutory audits and audit fees. Additionally, the study suggests maintaining the current audit firm tenure policy of the Central Bank of Nigeria (CBN), which stipulates a maximum tenure of ten years for a bank's external auditor, without extending it beyond this period.

Hassan et al. (2020) conducted an inquiry to explore the impact of audit quality on earnings management within the realm of listed deposit money banks in Nigeria over the period 2012 to 2019. Employing a correlational research design, the study utilized data extracted from the annual reports of listed deposit money banks in Nigeria and grounded its investigation in agency theory, establishing conceptual relationships among the variables of interest. The initial population comprised 14 listed deposit money banks, with the adjusted population being narrowed down to 12 listed deposit money banks in Nigeria. Panel regression served as the analytical tool for the collected data. The study's outcomes revealed a positive and significant correlation between audit industry specialization and earnings management in listed deposit money banks. Conversely, audit tenure demonstrated a negative and significant relationship with earnings management in listed deposit money banks. As a recommendation, the study proposes that regulatory authorities in Nigeria, such as the Securities and Exchange Commission (SEC), formulate policies that incentivize audit firms to establish specialized departments aligned with the industry lines of companies listed on the Nigerian Stock Exchange (NSE). Additionally, the study suggests the implementation of an auditor tenure policy of three years and above for external auditors of public companies in Nigeria.

Awa and Obinabo (2020) conducted an investigation into the impact of auditor's independence, audit firm size, and auditors' tenure on the earnings of shareholders in listed industrial goods firms in Nigeria. Employing an Ex post-facto research design, the study utilized a panel data regression model with E-views 9.5 statistical software to analyze data spanning from 2012 to 2018. The research findings indicated that auditors' independence and audit firm size had a positive and significant effect on the earnings of shareholders in listed industrial goods firms in Nigeria. Conversely, auditors' tenure demonstrated a negative and insignificant effect on shareholders' earnings in the same context. The implications of these findings suggest that investors and stakeholders should prioritize financial reports from firms audited by independent auditors and large audit firms (Big 4). It is crucial to pay particular attention to the length of audit tenure, as longer tenures may compromise audit quality and, consequently, the reliability of reported earnings.

Joel and Ramat (2018) investigated the impact of audit quality and corporate governance on earnings management within quoted Deposit Money Banks (DMBs) in Nigeria. The study specifically focused on examining how audit tenure, audit fee, board independence, and board size influence earnings management in DMBs. Employing an explanatory research design, the study utilized secondary data sourced from the annual reports and accounts of all 15 quoted DMBs on the Nigerian Stock Exchange as of December 31, 2015, spanning a 10-year period from 2006 to 2015. Panel regression analysis was employed to analyze the data. The findings indicated that board independence had a negative and significant effect on earnings management, while audit fee exhibited a positive and significant effect on earnings management. Additionally, audit tenure demonstrated a negative and significant impact on earnings management of DMBs. Surprisingly, board size was statistically not significant. The study recommended that regulatory authorities responsible for banking supervision in Nigeria, such as the Securities and Exchange Commission (SEC) and the Central Bank of Nigeria (CBN), should advise the National Assembly to pass legislation enforcing a three-year professional requirement for audit tenure.

Falola (2018) investigated the influence of auditor independence, audit tenure, and aggressive earnings management in listed banks in Nigeria. Data were collected from the audited annual reports of sampled firms spanning from 2006 to 2016 and were analyzed using the strata statistical tool. The study employed panel data regression analysis to test three formulated hypotheses. The findings indicated a significant relationship between audit tenure and aggressive earnings management in a firm. Moreover, auditor independence was found to have a direct and significant impact on aggressive earnings

management in the financial statements. Additionally, the study revealed a negative relationship between audit firm size and aggressive earnings management. Based on these findings, the study recommended the establishment of an independent auditing regulatory body and the implementation of specialized auditing training programs for individuals aspiring to become professional auditors.

## METHODOLOGY

The study utilized an ex-post facto research design with a positivist approach to investigate the statistical associations among variables. The population comprised all ten (10) listed deposit money banks within the financial service sector on the Nigerian Exchange Group (NGX) as of December 31, 2022, detailed in Appendix A. Nine (9) listed deposit money banks were selected based on specific criteria, requiring a firm to be quoted on the Nigerian Exchange Group (NGX) and operational throughout the period from 2012 to 2022.

Data were extracted from the annual financial reports of these banks and analyzed using multiple regression analysis for panel data. The dependent variable, 'earnings management,' was measured by 'absolute discretionary accrual,' and the independent variable, 'audit quality,' was characterized by audit firm size, audit fee, audit tenure, and joint audit. The control variable, 'firm size,' was also measured.

The study adopted a robust random effect model to analyze the data and establish the relationship between the dependent and independent variables. Robustness tests, including the Correlation Matrix, Variance Inflation Factor (VIF), Skewness/Kurtosis Normality Test, and Hausman Specification Test, were conducted to ensure the reliability of the results. The research aimed to assess the impact of audit quality on earnings management in listed deposit money banks in Nigeria and ascertain the moderating effect of firm size on the relationship between audit quality and earnings management in listed deposit money banks in Nigeria.

$ADA = f(AFZ + JA + AUFEE + AUTEN + FSZ)$

The econometrically, the model is stated thus:

$ADA = \alpha + \beta_1 AFZ_{it} + \beta_2 JA_{it} + \beta_3 AUFEE_{it} + \beta_4 AUTEN_{it} + \beta_5 FSZ_{it} + \varepsilon$

Where

ADA = Absolute Discretionary Accrual

AFZ = Audit Firm Size

JA = Joint Audit

AUFEE = Audit Fee

AUTEN = Audit Tenure

FSZ = Firm Size

$\alpha$  = constant

$\varepsilon$  = error terms

i = firms

t = periods

## Variables Measurement and Justification

**Table 1:** Variables Measurement and Justification

Variable	Type	Measurement	Justification
Absolute Discretionary Accrual (ADA)	Dependent	CFO is cash flow from operation for firm <i>i</i> in year <i>t</i> ; Sales <i>i, t</i> is sales revenue in period <i>t</i> for firm <i>i</i> ; $\Delta$ Sales <i>i, t</i> is change in sales revenue.	Efstathios (2013), Teshima and Shuto (2008), Wafa and Younnes (2014) and Yahaya <i>et al.</i> (2019).
Audit Firm Size (AFZ)	Independent	Measured by Dummy variable (One (1) if the firm is audited by a Big four audit firms and Zero (0) if otherwise	Rashidat <i>et al.</i> (2022), Aondoakaa and Achika (2022) Ada and Stella (2022)
Joint Audit (JA)	Independent	Measured by Dummy variable (One (1) if the firm is audited by two or more audit firms and Zero (0) if otherwise	Holm and Thinggaard (2009)
Audit Fee (AUFEE)	Independent	It is measures using a log of total audit fee.	DeAngelo( 1981); Francis, 2004; Hay and Davis, 2004
Audit Tenure (AUTEN)	Independent	This is measures with number of consecutive years that the client has retained a particular audit firm.	Okolie, 2015; Vanstraelen, 2000.
Firm Size (FSZ)	Control	Log of total assets.	Shhu andJibril (2012).

**Source:** Researcher's Compilation (2023)

## DATA ANALYSIS AND DISCUSSION OF FINDINGS

The dataset in Appendix B encompasses information from nine (9) deposit money banks, including absolute discretionary accrual (ADA), audit firm size (AFZ), joint audit (JA), audit fee (AUFEE), audit tenure (AUTEN), and firm size (FSZ), spanning the years 2012 to 2022. Utilizing Stata 15 software, the data underwent analysis employing descriptive statistics, Shapiro-Wilk Normality Test, Pearson Correlation, Variance Inflation Factor (VIF), Heteroscedasticity test, Breusch-Pagan Lagrangian Multiplier Test, Hausman Specification Test, and a Random Effect Regression Model. Detailed results of the analysis are provided in Appendix C, which is attached for reference.

### Descriptive Statistics

**Table 2** Summaries of the descriptive statistics of the entire data set.

Variable	Obs	Mean	Std. Dev.	Min.	Max.
ADA	94	0.016	0.036	0.0001	0.282
AFZ	98	0.633	0.484	0.00	1
JA	99	0.879	0.328	0.00	1
AUFEE	99	8.288	0.299	7.255	9.255
AUTEN	98	0.632	0.484	0.00	1
FSZ	99	9.140	0.665	6.27	10.07

**Source:** Researcher's Computation using STATA 15 software

Table 2 presents a comprehensive overview of various variables. Absolute Discretionary Accrual (ADA) ranges from a minimum of 0.0001 to a maximum of 0.282, with a mean value of 0.016, indicating a well-distributed spread over the studied period. The standard deviation of ADA is 0.036, exceeding the mean, signifying robust growth during the review period. Audit firm size (AFZ) spans from a minimum of 0.00 to a maximum of 1, with a mean value of 0.633, demonstrating a good distribution within the studied timeframe. AFZ exhibits a standard deviation of 0.484, less than the mean, suggesting a gradual growth over the review period.

Table 3 illustrates the characteristics of joint audit (JA), showcasing values ranging from a minimum of 0.00 to a maximum of 1, with a mean value of 0.879. JA displays a standard deviation of 0.328, less than the mean, indicating measured growth during the period under consideration.

Furthermore, Table 2 details the audit fee (AUFEE), with a minimum value of 7.255, a maximum value of 9.255, and a mean value of 8.288, denoting a well-distributed spread. AUFEE's standard deviation is 0.299, less than the mean, suggesting gradual growth throughout the review period.

Similarly, Table 2 provides insights into audit tenure (AUTEN), spanning from a minimum of 0.00 to a maximum of 1, with a mean value of 0.632. AUTEN displays a standard deviation of 0.484, less than the mean, indicating measured growth over the study duration. Lastly, Table 2 outlines the firm size (FSZ), with a minimum value of 6.27, a maximum value of 10.07, and a mean value of 9.140. FSZ exhibits a standard deviation of 0.665, less than the mean, suggesting gradual growth during the review period.

**Shapiro Wilk Normality Test**

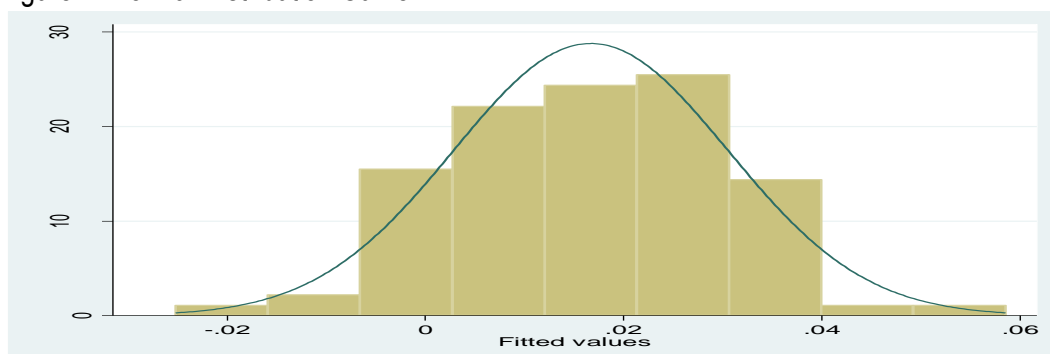
Table 3 and Figure 2 showcase the outcomes of the normality test performed using the Shapiro-Wilk normality test and a visual representation with the normal distribution curve. The criterion for decision-making is based on the P-Value: if P-Value > 0.05, it indicates that the residual is normally distributed; however, if P-Value is equal to or < 0.05, the residual is considered not normally distributed.

Table 3: Shapiro-Wilk normality test

Variable	OBS	W	V	Z	Prob>Z
Residual	97	0.991	0.695	-0.806	0.789

**Source:** Researcher’s Computation using STATA 15 software

Figure 2: Normal Distribution Curve



**Source:** Researcher’s Computation using STATA 15 software

Table 3 displays the residual, indicating a z-value of -0.806 and an associated probability value of 0.789, which is greater than 0.05. This outcome signifies that the residual is normally distributed around the mean. The normal distribution curve presented in Figure 2 above supports this result. Consequently, it can be inferred that one of the fundamental assumptions of the linear regression technique, which requires normally distributed residuals, has been met.

**Pearson Correlation**

Table 4 presents the Pearson correlation matrix for the dataset, illustrating the degree of associations among the variables. The decision criterion is that if a pair or more of the independent variables equals or exceeds 0.85, multicollinearity is present in the model. Conversely, if the correlation among independent variables is less than 0.85, there is no indication of multicollinearity in the model.

Variable	DA	AFZ	JA	AUFEE	AUTEN	FSZ
DA	1					
AFZ	0.0547	1				
JA	0.0919	-0.1555	1			
AUFEE	-0.3310	0.0443	-0.0583	1		
AUTEN	0.0212	0.1166	-0.0264	-0.0202	1	
FSZ	-0.2487	0.1195	-0.1138	0.5075	0.2063	1

**Source:** Researcher’s Computation using STATA 15 software

The correlation matrix assesses the relationships between the proxies of an independent variable and the dependent variable. It also helps identify associations among the proxies of independent variables, indicating the presence of multicollinearity in the model. The results from Table 4 indicate a 5% positive relationship between audit firm size (AFZ) and absolute discretionary accrual (ADA) in Nigerian deposit money banks, with a correlation coefficient of 0.0547. Additionally, a 9% positive relationship is observed between joint audit (JA) and absolute discretionary accrual (ADA), with a correlation coefficient of 0.0919.

Moreover, the table reveals a 33% negative relationship between audit fee (AUFEE) and absolute discretionary accrual (ADA) in Nigerian deposit money banks, indicated by a correlation coefficient of -0.3310. The analysis also shows a 2% positive, weak association between audit tenure (AUTEN) and absolute discretionary accrual (ADA) with a correlation coefficient of 0.0212. Furthermore, the table illustrates an approximately 25% negative and weak association between firm size (FSZ) and absolute discretionary accrual (ADA) in Nigerian deposit money banks, represented by a correlation coefficient of -0.2487. Notably, the relationships among proxies of independent variables themselves are mild, with all coefficients below the suggested threshold of 0.80 by Gujarati (2003), indicating no presence of multicollinearity in the model.

**Heteroscedasticity Test Results**

**Table 6:** Heteroscedasticity test

Type of test	Chi2	P-Value
Heteroscedasticity Test	84.96	0.0000

**Source:** Researcher’s Computation Using STATA 15 software

To ensure the robustness of the data for this study, a heteroscedasticity test was conducted. The decision criterion stipulates that if the P-value is  $\leq 0.05$ , there is evidence of heteroscedasticity;

conversely, if the P-value is > 0.05, there is no indication of heteroscedasticity. The findings indicated that the data exhibited heteroscedasticity, indicating a violation of the assumptions of the basic linear regression model. This conclusion is supported by the results in Table 6, revealing a chi-square value of 84.96 with a p-value of 0.000. The failure to meet the classical linear regression assumption of homoskedasticity (constant error variance) underscores the need for a robust regression model.

**Breusch-Pagan Lagrangian Multiplier Test**

Table 7 below presents the result of the Breusch-Pagan Lagrangian Multiplier test conducted.

Variable	Chibar2	P-Value
ADA	17.96	0.0000

**Source:** Researcher’s Computation using STATA 15 software

Table 7 indicates that the Breusch-Pagan Lagrangian Multiplier test was performed, yielding a chi-square value of 17.96 and a corresponding probability of 0.00 for all the models (p=0.000). As a result, the null hypothesis is accepted. The significance of the chi-square in the Lagrangian Multiplier test indicates that the variance of the random effect model is zero (0). Consequently, the Random Effect Regression Model (REM) is deemed more appropriate than the Pooled Effect Model.

**Hausman Specification Test**

Table 8 below presents the result of a Hausman specification test conducted.

Chi2	9.52
Prob. Chi2	0.0900

**Source:** Researcher’s Computation using STATA 15 software

The data used in this study is panel data, which may introduce errors that are clustered and potentially correlated over time. This is due to the possibility that each bank possesses entity-specific characteristics influencing its ownership structure, resulting in unobserved heterogeneity. Such factors could introduce bias to both the outcome variable and the explanatory variables. Therefore, it becomes essential to account for this potential bias. To address this, the Hausman test was conducted, indicating that the random effect model is more suitable than the fixed effect model. This is affirmed by the Chi2 value of 9.52 with a p-value of 0.0900 in table 8, which is not significant at any conventional level of significance.

**Results of Random Effect Regression Model**

Table 9 presents the results of the robust random effect regression model used for estimating this study's model.

Variable	Coefficients	z-value	Prob.
Cons.	-0.054	-0.86	0.390
AFZ	0.034	1.26	0.209
JA	0.005	2.93	0.003
AUFEE	0.011	2.17	0.030
AUTEN	0.003	0.49	0.626
FSZ	-0.003	-0.52	0.602
R-sq overall	0.6016		
Wald chi2	111.29		
Prob. >chi2	0.0459		

**Source:** Researcher’s Computation using STATA 15 software

Table 9 indicates that 60% of the variation in absolute discretionary accrual (ADA) can be predicted by the collective influence of audit firm size (AFZ), joint audit (JA), audit fee (AUFEE), audit tenure (AUTEN), and firm size (FSZ) (Overall R-sq of 0.6010). The Wald chi2 value of 111.29 with a Prob. >chi2 of 0.0459 suggests that the model is appropriate for the study. This implies that the study's model is well-fitted, and the independent variables are effectively combined and utilized.

### Test of Hypotheses

To investigate the impact of audit quality on the earnings management of listed deposit money banks in Nigeria, the formulated hypotheses were subjected to testing using a robust random effect regression model.

The outcomes presented in Table 9 indicate that the z-value of 1.26, with a corresponding p-value of 0.209, signifies that audit firm size has an insignificant positive effect on the absolute discretionary accrual of deposit money banks in Nigeria during the reviewed period. Consequently, the acceptance of null hypothesis one, which posits that audit firm size has no significant effect on the absolute discretionary accrual of quoted deposit money banks in Nigeria.

Table 9 further illustrates a z-value of 2.93, accompanied by a p-value of 0.003, indicating that joint audit (JA) has a significant positive effect on the absolute discretionary accrual of quoted deposit money banks in Nigeria for the period under consideration. This leads to the rejection of null hypothesis two, suggesting that joint audit (JA) has no significant effect on the absolute discretionary accrual of quoted deposit money banks in Nigeria.

Additionally, Table 9 reveals a z-value of 2.17, with a corresponding p-value of 0.030, indicating that audit fee has a significant positive effect on the absolute discretionary accrual of quoted deposit money banks in Nigeria for the period under scrutiny. Consequently, null hypothesis three, stating that audit fee has no significant effect on absolute discretionary accrual, is rejected.

Lastly, Table 9 shows a z-value of 0.49 and a corresponding p-value of 0.626, suggesting that audit tenure has an insignificant positive effect on discretionary accrual of quoted deposit money banks in Nigeria for the period reviewed. Thus, null hypothesis four, asserting that audit tenure has no significant effect on absolute discretionary accrual of quoted deposit money banks in Nigeria, is accepted.

### Discussion of Findings

This study indicates that audit firm size exhibits an insignificant positive effect on the discretionary accrual of deposit money banks in Nigeria. The results suggest that an increase in audit firm size leads to a rise in absolute discretionary accrual for quoted deposit money banks in Nigeria, by 0.034. Contrary to expectations based on agency theory, which emphasizes the role of auditing in mitigating agency conflicts within the principal-agent relationship, this finding aligns with the outcomes of prior research conducted by Aondoakaa and Achika (2022). However, it diverges from the findings reported by Awa and Obinabo (2020), Masoyi et al. (2015), and Orbunde et al. (2020). The study further highlights that joint audit (JA) demonstrates a significant positive effect on the absolute discretionary accrual of quoted deposit money banks in Nigeria. The results suggest that an increase in joint audit (JA) results in an augmentation of discretionary accrual for deposit money banks in Nigeria, by 0.005. This finding contradicts the expectations of agency theory, emphasizing the role of auditing in mitigating agency conflicts. However, it aligns with the conclusion drawn by Masoyi et al. (2015). Additionally, the study uncovers that audit fee (AUFEE) exhibits a significant positive effect on the absolute discretionary

accrual of quoted deposit money banks in Nigeria. The outcomes indicate that an increase in audit fees leads to an elevation of absolute discretionary accrual for quoted deposit money banks in Nigeria, by 0.011. This finding, inconsistent with the expectations of agency theory, resonates with the results obtained by Ada and Stella (202) and Joel and Ramat (2018).

Moreover, the study reveals that audit tenure (AUTEN) demonstrates an insignificant positive effect on the absolute discretionary accrual of quoted deposit money banks in Nigeria. The findings imply that an increase in audit tenure results in a marginal increase in absolute discretionary accrual for quoted deposit money banks in Nigeria, by 0.003. This outcome, contrary to the predictions of agency theory, is consistent with the results reported by Ada and Stella (202), Aondoakaa and Achika (2022), Falola (2018), Hassan et al. (2020), and Joel and Ramat (2018). However, it differs from the conclusions drawn by Awa and Obinabo (2020).

### **CONCLUSION AND RECOMMENDATIONS**

Based on the findings of this study, it can be concluded that the size of the audit firm has a marginal positive impact on the discretionary accruals of deposit money banks in Nigeria. Consequently, opting for a larger audit firm may result in a slight increase in earnings management for quoted deposit money banks in Nigeria. However, it is crucial to note that this incremental effect is deemed insignificant, suggesting that other factors might exert a more substantial influence on the discretionary accruals of these banks.

Furthermore, the adoption of joint audit practices significantly influences the earnings management of quoted deposit money banks in Nigeria. The rise in joint audits correlates with an increase in the utilization of discretionary accruals by the banks. This underscores the potential impact of joint audits on the financial reporting practices and discretionary accrual decisions of banks in Nigeria.

The escalation in audit fees also contributes to a heightened level of earnings management among quoted deposit money banks in Nigeria. To address this, deposit money banks in Nigeria should consider reducing the substantial audit fees paid to external auditors for audit assignments. This reduction aims to incentivize auditors to report on actual issues in the financial statements, as exorbitant audit fees may encourage reporting in favor of clients, thereby increasing the level of earnings management.

Extended audit tenure exhibits a positive correlation with the earnings management of quoted deposit money banks in Nigeria. An augmentation in audit tenure directly corresponds to an upsurge in earnings management for these banks. Consequently, it is imperative for deposit money banks in Nigeria to discourage prolonged audit tenures. This measure aims to mitigate familiarity between the management and external auditors, ultimately curbing the level of earnings management within the banking sector.

Based on the aforementioned conclusions, the following recommendations are put forth:

- (i) Deposit money banks in Nigeria should diversify their choice of audit firms beyond the big four, aiming to engage non-big-four audit firms for financial statement audits. This approach is intended to discourage financial statement manipulations and minimize absolute discretionary accrual within the institutions.

- (ii) Deposit money banks in Nigeria should refrain from appointing multiple audit firms to conduct audits concurrently in the same accounting period. This practice is advised to reduce absolute discretionary accrual within the institutions.
- (iii) Deposit money banks in Nigeria should ensure the provision of adequate and appropriate audit fees to their external auditors, commensurate with the complexity of the audit assignment. This measure is expected to incentivize auditors to report accurately on financial statements and diminish the tendency to manipulate reports in favor of clients, thereby reducing the level of earnings management.
- (iv) Deposit money banks in Nigeria should adopt a policy of granting a single audit tenure to minimize familiarity between the management and external auditors. This step aims to curtail the level of earnings management within these institutions.

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