Effect of Audit Fees and Audit Tenure on Earnings Management of Listed Deposit Money Banks in Nigeria

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Authors' contributions

This work was carried out in collaboration between both authors. Both authors read and approved the final manuscript.

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ABSTRACT

This paper assesses the effect of audit fees and audit tenure on earnings management of listed deposit money banks in Nigeria. The population consists of the 14 DMBs in Nigeria spanning from 2011 to 2021, out of which twelve banks were selected as the sample size using a criterion on the availability of data. The paper uses a longitudinal research design to investigate the effect of audit fees and audit tenure on the earnings management of listed DMBs in Nigeria. The audited financial annual reports of the banks chosen were used to collect data for the independent variables such as audit fees and audit tenure, as well as the dependent variable earnings management. The Generalized Method of Moment (GMM) was then employed for analyzing the data. The result shows that audit fee had a coefficient of -0.1461at a significant level of 0.0000. Audit tenure has

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positive coefficient of 0.1405at a significant level of 0.0001 influences on listed DMBs' management of earnings in Nigeria. The study therefore concludes that, audit fee curtail EM of listed DMBs in Nigeria while audit tenure do not ameliorate EM of listed DMBs in Nigeria. In order to prevent the threat of familiarity, the paper recommends that DMBs in Nigeria should stick to the statutory and professional standard audit fees and discourage long-term audit firm retention.

1. INTRODUCTION

Financial statements generated by management of firms are of utmost importance [1]. In their capacity as shareholders' agents, managers are expected to work in their best interests and provide accurate financial data to shareholders and other interested parties so that they can assess the reporting entity's operations and financial position [2]. The shareholders and management of a business firm, who participate in the daily running of the business, are put in a position where there is conflict of interest and information asymmetry. Conflict can sometimes be seen in the financial statements preparation process when managers choose to smooth out financial data in publish financial reports for their own benefit at the expense of the stakeholders [3]. Managers may covertly misuse every level of flexibility at their control to report the company's earnings or draw picture of the company's future which eventually will reduce the quality of financial reporting and audit quality [4,5]. Managers can accomplish this using a variety of strategies referred to as "earnings management." Therefore, EM is described as management choosing accounting measurement or reporting standards repeatedly in a specific pattern with the intention of presenting an income stream with a smaller variance from a trend than would have otherwise been apparent [3].

However, the quantity of the audit fee is the most important element that can compromise audit quality and its independence. According to the body of existing literature a higher audit charge represents more auditor labor and hence a higher audit quality. Because of the contradictory empirical results, the discussion of the connection between audit fees and earnings management is never-ending [6]. Audit tenure is an important aspect of audit quality, as it can impact the independence and objectivity of the auditor [7]. Junaidu & Ishaku [8] who carried out their study on non financial companies documented a significant positive relationship between audit quality and EM. Recording that, more prolonged audit stay could lead to an absence of credibility and objectivity from the auditor. While Livinus [9] contradict the findings of Junaidu & Ishaku [8] by reporting a significant negative effect between audit quality and EM, by documenting that long audit tenure leads to deeper understanding of the clients business and its internal control, which eventually leads to improve audit quality.

However, accounting manipulation has been a problem and will continue to be a continuous problem as reported in many different contexts [10]. The rise of financial scandals such as Xerox (2000), Enron (2001) and WorldCom (2002) in Europe and the United States has been widely debated how important external audit quality is in attempting to stop these unfortunate occurrences [11]. In a similar vein, the failure of numerous institutions, including Cadbury Nigeria Plc in 2006, Bank PHB, Afri Bank, Intercontinental Bank, Oceanic Bank, the case of African Petroleum Plc where a credit facility of 24 billion naira was not disclosed in the financial statement, Alpha Merchant Bank, Society General Bank Limited, and Savannah Bank, as well as Stanbic IBTC Plc in 2016, Diamond Bank in 2018 to name a few, have raised questions about the reliability of reported earnings and the credibility of financial reporting [8]. Also the scenario observed in the First Bank published in 2021, where authorities identified over 150 billion non-performing loans and improper credit decisions, of which 75 billion belonged to the board chairman alone (Emefiele, 2021). However, the ability of audit quality to successfully control EM across corporations has also been questioned in light of the corporate accounting scandals (Yasser & Soliman, 2018).

This paper is also motivated by the researcher for the fact that previous studies in this field ware conducted in developed countries and concentrated on other sectors of the economy which documented mixed results. These studies include: Ana [10], Lopes [12] Martinez and Mores [13] and Nawaiseh [14] to mention few. Additionally, among the studies conducted in Nigeria. Like the study of Aliyu [15] conducted his

study focusing on the consumer goods company in Nigeria using a purposive sampling technique which made his selection of the sample size not scientific. Secondly, the study of Kwarbi and Osho [16] , drew 16 firms from a population of 192 consumer goods companies which in essence 16 companies cannot make a good representation of 192 companies as it only covers 8% of the entire population. There is also a shortfall in the study of Jayeola et al. [17] who conducted his study on Nigerian banks using 6 DMBs to represent a population of 15 DMBs in Nigeria.

It is based on the aforementioned problems that this paper seek to achieve its objectives by investigating the effect of audit fees and audit tenure on earnings management of listed Deposit Money Banks in Nigeria. Base on these objectives; the paper hypothesized that:

> **H$_1$:** There is no significant effect between audit fee and earnings management of listed DMBs in Nigeria.

> **H$_2$:** There is no significant effect between audit tenure and earnings management of listed DMBs in Nigeria.

The outcome will have a significant impact on policy for regulators working to enhance the financial sector's transparency and quality of financial reporting, particularly when determining how effective the current audit fee and audit tenure are at guaranteeing accurate financial reports free from misstatement.

2. LITERATURE REVIEW

2.1 Conceptual Review

Concepts including fees for auditing, audit tenure, and earnings management are addressed in this section. The section concludes with a discussion of theories that follow the further analysis of empirical literature regarding the variables under investigation.

2.2 Earnings Management

Earnings management is defined as management choosing accounting measurement or reporting procedures repeatedly in a specific pattern with the intention of reporting an income stream with a lower variance from a trend than would otherwise appear [3].

2.3 Audit Fees

The monetary payment that accounting firms and auditors receive for their professional services is referred to as an audit fee. The determination of audit cost requires mutual consultation between the audited unit and the accounting firm [18]. In order to ensure the quality of the audit report as an important part of the auditor incentive mechanism, the establishment of reasonable audit fees is a necessary condition to ensure that the certified public accountants perform the normal information assurance function and ensure the effective operation of the audit work [6].

2.4 Audit Tenure

Is the number of periods-years an audit firm, an auditor audit a client's company [8].

2.5 Review of Empirical Studies

The empirical literatures concerning the variables under study are reviewed in this section.

2.5.1 Audit fees and earnings management

A study conducted Egbunike et al. [19] examined the relationship between real income smoothing and residual fees and non-financial firms in Nigeria. 75 businesses in the non-financial sector's financial statements covering the years 2010 through 2019 were the source of the secondary data. A modified model was used in the study to estimate the residual audit fee, and for evaluation of the hypotheses, the dynamic panel estimation approach was applied. The results showed that the smoothing of residual audit fee revenues had a strong negative relationship.

Also, Aliyu [15] examines the impact of audit quality on the earnings management of listed consumer products firms in Nigeria between 2006 to 2018. The research design was ex-post facto. Twenty one publicly traded consumer goods companies made up the population, of which seventeen were carefully selected as the number of samples using the purposive sampling technique. The annual reports of the sampled companies provided the data, which were then subjected to panel adjusted standard error regression analysis. The results demonstrated that managing earnings is significantly harmed by an audit charge. But, however, the sampling

technique used could be subjective because the method applied in arriving at the sample size was not scientific.

However, Kwarbi and Osho [16] did a study on the listed Nigerian consumer goods industry's to examined audit quality and earnings management. 16 consumer goods were chosen as the sample size from 2010 to 2019 from the 192 firms quoted on the NSE, which made up the study's population. The study, which applied an ex-post factor research methodology, made use of secondary data. The audit charge functioned as an interim measure for audit quality. The analysis employed OLS and Pearson correlation. The management of earnings and audit fees were found to be positively and significantly correlated. In addition 16 companies cannot make a good representation of 192 companies and make generalization. This is because it only covers 8% of the entire population.

In addition, Nawaiseh [14] Examine the hypothesis that, in Jordanian banking firms listed on the Amman Stock Exchange (ASE), external audit quality is positively correlated with earnings management. Audit fees are a constant barometer of audit quality. The findings showed an excellent connection among the variables.

However, the above studies established positive effect on audit fees on EM practice. On the other hand some studies shows a negative effect on EM. On of these studies is the study of Martinez and Moraes [13] Researchers examined the connection between audit fees and earnings management in the Brazilian market using a sample of 300 businesses listed on the BM & FBovespa and data from the econometric database and the Brazilian Securities Commission's website. The study used multiple regressions to analyze the data. The results demonstrated a significant and negative link between audit fee and earnings management, suggesting that audit firms charging lower service fees are typically less cautious when it comes to managing the earnings of their clients' businesses.

2.5.2 Audit tenure and earnings management

Aliyu [15] from 2006 to 2018, the study looks at how audit quality affects earnings management of listed consumer goods businesses in Nigeria. The research design was ex-post facto. Twenty one publicly traded consumer goods companies made up the population, of which seventeen

were carefully chosen as the sample size using the purposive sampling technique. The annual reports of the sampled companies provided the data, which were then subjected to panel adjusted standard error regression analysis. The results showed that audit tenure significantly improves earnings management. But, however, the sampling technique used could be subjective because the method applied in arriving at the sample size was not scientific.

Also, Kwarbi and Osho [16] did a study on the listed Nigerian consumer goods industry's audit quality and earnings management. 16 consumer goods were chosen as the sample size from 2010 to 2019 out of the 192 firms quoted on the NSE, which made up the study's population. The study used ex-post factor research technique and used secondary data, with audit tenure served as a proxy for audit quality. The analysis employed OLS and Pearson correlation. A favorable and significant link between the variables was discovered by the investigation. The report suggests that management of Nigerian listed companies should continue to provide earnings that are steady and consistent. In addition 16 companies cannot make a good representation of 192 companies and make generalization. This is because it only covers 8% of the entire population.

However, Livinus [9] studied how listed Nigerian consumer goods manufacturing companies manage their earnings and audit quality. Earnings management was modeled using discretionary accruals and earnings restatement, and audit tenure served as a model for audit quality. Thirteen of the 26 listed consumer goods manufacturing firms were arbitrarily chosen for the study's sample size, which covered the years 2012 to 2018. The study used a total population of 26 listed consumer goods manufacturing firms from their annual reports. Univariate, Bivariate, and Multivariate analysis were used to test the data. Using E-view 10's econometric software, univariate/descriptive, bivariate, Pearson Product Moment Correlation (PPMC), and multivariate regression approaches. The results of the study show that there is no relationship between audit tenure and discretionary accruals at Nigerian listed makers of consumer products.

However, Junaidu and Ishaku [8]. In Nigerian listed non-financial corporation's from 2012 to 2018, the study looked at the relationship between audit quality and earnings management. Data were taken from the non-financial

companies' annual reports and financial statements. Using an exposed-facto research design, the Arellano-Bond dynamic panel-data estimate approach was used to assess the data. The results suggested that longer audit tenure increases earnings management because there was a significant correlation between audit tenure and discretionary accruals. The report suggests that extended audit tenure be discouraged in light of the findings.

2.6 Theoretical Review

The paper is underpinned by two theories; the positive accounting theory and agency theory.

The positive accounting theory, Watts and Zimmerman [20] highlighted three main hypotheses for PAT. These theories, which explain why managers select a particular accounting technique over another, are the political cost hypothesis, the bonus plans hypothesis, and the debt equity hypothesis. The bonus plan hypothesis both support the idea that managers with accounting incentives or figures are better off than they otherwise would have been. In order to motivate the management, depreciation procedures, non-collectable allowances, and research development costs will all be handled differently. According to the debt equity hypothesis, managers will often manipulate financial statements to appear more profitable than they actually are. This is done in the hopes of improving performance and liquidity, which will improve their ability to pay back principal and interest to the debt owners. Furthermore, political cost theory assumes that businesses will typically embellish their financial accounts in a way that avoids drawing the notice of legislators or other decision-makers, preventing them from being subjected to unfavorable or additional tax or compliance laws.

Agency theory propounded by Jensen and Meckling [21] clarifies the association between the proprietors of the business the (principal) and the managers, the (agents). The study views the principal as the (shareholders) while the agents as the (managers). The shareholders appoint the managers to operate their businesses on their behalf and expect them to act in their best interest, whose interest is on the earnings and financial well-being of the firm. However, sometimes the agents, being the (managers) go against the wish of the principals (shareholders) by acting to satisfy their interest rather than that of the (shareholders). Therefore, in this

circumstance, audit quality is considered to be a control function for managers to reduce possible conflicts.

3. METHODOLOGY

3.1 Design

A longitudinal research design is used in this study. This is due to the fact that it entails several observations of the same units made throughout time. The fourteen (14) DMBs that were listed on the Nigerian Stock Exchange (NSX) Group as of December 31, 2021, make up the study's population; 12 of these were chosen as the sample size using fettering criteria. The audited annual financial statements of the sampled banks covering the years 2011–2021 served as a secondary source of data for the article, which looked at how the independent variables affected the dependent variable of listed DMBs in Nigeria. The analysis of the panel data for eleven years ranging from 2011-2021 was analyze using the generalized method of moments (GMM) developed by Arellano and Bond [22]. This paper adopted the Chang et al [23] model as used in the study of Isa and Farouk, [3] to measure the dependent variable EM which is represented by discretionary loan loss provision. The independent variables are measured as: Audit fee is measured by natural lag of audit fees paid by the firm. Source Tyakoso & Tsegba [24] Nawaiseh [14] Audit tenure is measured by length of audit client relationship (1) if 3 years+ and 0 if otherwise. Source, Kurawa & Ishaku [25], Okolie [26].

3.2 Model Specification

Earnings management which is represented by discretionary loan loss provision (DLLP), this paper adopted the chang et al. [23] model as used by Isa & Farouk, [3] which is specifically built for financial sectors. It is through this model that the residual of the second model is obtained. The model is specified below:

$$DLLP/TA_{t-1} = LLP_{it}/TA_{t-1} - (\alpha_0 \, 1/TA_{t-1} + \alpha_1 \, LCO_i/TA_{t-1} + \alpha_2 BBAL_i/TA_{T-1}) \tag{1}$$

Where:

DLLP = Discretionary Loan Loss Provision
LLP = Loan Loss Provision
LCO = Loan Charge-off
BBAL= Beginning Balance of Loan Loss
TA_{T-1} = Lagged Total Asset
a_0 = Constant
$\alpha 1, \alpha 2$ = firm specific parameters

The second model was adapted and re-modified as used in the study of Ahmad et al. [27] to estimate the measure of the predictive ability of audit quality on earning management of listed DMBs in Nigeria. The model is presented in the following equation:

$$DLLP_{it}=\beta_0+\beta_1AF_{it}+AT_{it+} \text{ } eit \quad\quad (2)$$

Where:

DLLP = Discretionary Loan Loss Provision
AF =Audit Fee
AT= Audit Tenure
b_0 = Constant
$\beta_1 - \beta_2$ = Coefficient of explanatory variables
eit = error term represents the effect of all those variables that were omitted from the regression equation.
It = Companies and Time

4. RESULTS

4.1 Discussion

The results of the panel unit root tests, panel co-integration test, correlation matrix test (multicollinearity test), and generalized method of moment (GMM) estimation are included in this section. Table 1 presents the results in descriptive statistics.

Table 1 indicates that both the audit tenure and audit fees have positive means. This explains

why, during the course of the study, the variables showed positive increases. However, the mean of earnings management (measured by discretionary loan provision) is negative. This explains that over the study period that, earnings management of the listed DMBs in Nigeria adverse decline overtime. Additionally, the estimation result confirms that the variable deviates from its mean, with earnings management (DLLP) having the biggest standard deviation. Lastly, the series are not normally distributed, according to the Jarque-Bera coefficient for each variable. The probability values of every variable in the model are less than 5% threshold of significance, which reflects this. This study goes on to assess whether or not there is multicollinearity among the variables after determining the descriptive nature of the variables. Table 2, however, provides a summary and report of the outcome.

The correlation analysis of the variables is shown in Table 2 of this research. The findings show that audit tenure and audit fee, with corresponding correlation coefficients of 0.04 and 0.13, are favorably associated with earnings management. This suggests that a rise in these factors is linked to an increase in the listed DMBs in Nigeria's earnings management. Additionally, the findings indicate a negative correlation between audit fees and audit tenure. The results show that there is no multicollinearity among the variables, and the variables are appropriate to be

Table 1. Results of the summary statistic of variables

Statistic	DLLP	AF	AT
Mean	-32.5071	12.0818	0.6969
Median	-0.2201	12.2760	1.0000
Maximum	0.2511	16.2783	1.0000
Minimum	-4237.00	5.7307	0.0000
Std. Dev.	368.754	1.8201	0.4613
Skewness	-11.3575	-2.2014	-0.8571
Kurtosis	129.997	8.4138	1.7347
Jarque-Bera	91544.41	267.823	24.9694
Probability	0.0000	0.0000	0.0000
Obs.	132	132	132

Source: Author's computation using eviews VERSION 12.

Table 2. Correlation coefficients of the model

Variables	DLLP	AF	AT
DLLP	1.0000		
AF	0.0410	1.0000	
AT	0.1321	-0.0626	1.0000

Source: Author's computation using EViews Version 12

included in the same model for analysis. This is because there is no variable with correlation coefficient above 0.7. Going by the correlation results, this paper moves on to test the stationary behavior of the variables and the result is presented in Table 3.

As shown in Table 4's results of the Levin, Lin, and Chu test, audit tenure, audit fees, and earnings management are all stationary at first difference. However, the Im, Pesaran, and Shin test demonstrates that the integration of audit tenure, audit fees, and profits management is shown to be of order 1. This suggests that listed DMBs in Nigeria strive to maintain ongoing operations. After determining the descriptive nature, correlation behaviors of the variables and panel stationary tests, the paper goes further to investigate the evidence of co-integration among the variables. Table 4 summarizes and tabulates the findings.

There is evidence of co-integration between the variables, as Table .4 demonstrates. The t-statistic coefficient's statistical significance at the 1% level explains this. This leads to the rejection of the null hypothesis and the inference made in this work that the variables are co-integrated.

However after discovering the co-integration evidence, the paper uses Generalized Method of Moment (GMM) regression to investigate the effect of audit fees and audit tenure on the earnings management of the listed DMBs in Nigeria. From the estimation, the panel coefficients of the dependent variable (earnings management) have been generated in the estimate using Pool OLS, fixed effect, difference GMM, and system GMM regressions, with a view of selecting the best model between difference GMM and system GMM regression. However, according to Bond (2001) if the coefficient of the difference GMM estimation is lower or very close to the coefficient of the fixed effect estimation, the result suggest that the difference GMM is downward biased due to weak instrumentation and thus, the system GMM should be use instead. As a result, the findings are shown in Table 5.

The outcome demonstrates that the Generalized Method of Moment (GMM) system is more suitable, as shown in Table 5. This is due to the fact that the earnings management dependent variable's coefficient of lag value (-7.92) is lower than the fixed effect regression's coefficient (-0.14). The findings thus imply that the system

Table 3. Panel unit root tests

Variables	Levin, Lin and Chu Test		Im, Pesaran and Shin Test	
	Level	First Diff.	Level	First Diff.
DLLP	-4.6904	-10.4037***	-0.5714	-2.1556**
AF	-3.2705	6.5639***	0.5734	-2.0448**
AT	-0.2772	-2.0568**	-0.8962	-1.3889*

*Note: ***, ** and *significant at 1%, 5% and 10% respectively.*
Source: Computed by the author using EViews version 12

Table 4. Kao residual cointegration test results

t-Statistic	P-value
2.5950	0.0047***

*Note: *** significant at 1%.*
Source: Author's computation using EViews version 12

Table 5. Results of the system GMM regression

Dependent Variable: Earning Management				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
DLLP(-1)	0.0880	0.0908	0.9693	0.3349
AF	-0.3013	0.0648	-4.6507	0.0000
AT	0.2363	0.0591	3.9967	0.0001
Diagnostics				
POLS = 0.03, FE = -0.14, DGMM = -7.92, J. Stat. = 6.81 (0.9227), AR (1) = -0.82 (0.4104), AR (2) = -0.81 (0.4151)				

Note: PLS = Panel Least Square, FE = Fixed Effect, DGMM = Difference GMM, AR = Autocorrelation and
J-Sta. = Sagan Test,
Source: Author's compilation using EViews Version 12.

GMM ought to be applied and that the difference GMM is downward biased. The difference between the past value (lag value) of earnings management and the current earnings management is statistically not significant and has a negative association, according to the results. This suggests that during the course of this paper, a 1% increase in prior earnings management causes a 0.08% drop in current earnings management. As a result, the paper concludes that, the current value of earnings management is not significantly influenced by the past value of earnings management and the result is not statistically significant. The outcome confirms that, at 0.0000 p-value, there is a statistically significant negative link between audit fees and earnings management of listed DMBs in Nigeria. The earning management of Nigeria's listed DMBs decreases by 0.30% for every 1% rise in the audit charge. Nonetheless, the outcome demonstrates that, at 0.0001 p-value, there is a substantial positive association between audit tenure and earnings management of listed DMBs in Nigeria. This suggests that the profits management of listed DMBs in Nigeria increases by 0.23% for every 1% increase in audit tenure.

4.2 Hypotheses Testing and Discussion of Findings

This section discusses the result in relation to the findings and explains the extent to which the findings are similar or otherwise with the existing studies. The discussion captures the effect of audit fee, audit tenure and board independence on the earning management of listed DMBs in Nigeria.

4.2.1 Audit fee and earnings management

There is a strong and negative relationship between audit fees and earnings management, as indicated by the GMM result on Table 5, with a 0.0000 p-value. As a result, the alternative hypothesis is accepted and the null hypothesis, which claims that there is no meaningful relationship between audit fees and the earnings management of listed DMBs in Nigeria, is rejected. This finding is in line with Egbunike *et al.* [19] Aliyu [15] and Martinez and Moraes [13] who indicates that audit fees has significant negative effect on earnings management. And contradict the study of Kwarbi and Osho [16] Ibrahim and Ali [6] and Nawaiseh [14] who find a significant positive effect between audit fees and earnings management.

4.2.2 Audit tenure and earnings management

At 0.0001 p-value, the GMM result in Table 5 shows a positive and significant relationship between audit tenure and earnings management. As a result, the null hypothesis—which holds that there is no causal connection between audit tenure and listed DMB earnings management in Nigeria is rejected. This is in line Aliyu [15] Kwarbi and Osho [16] and Junaidu and Ishaku [8] who suggest that, audit tenure has significant positive effect on earnings management. And thus contradicts Jayeola et al. [17] and Livinus [9] who found no positive effect between audit tenure and earnings management.

5. CONCLUDING REMARKS

5.1 Conclusion

The impact of audit fees and audit tenure on the earnings management of Nigeria's listed DMBs is examined in this article. This study draws the following conclusions from its findings:

i. In line with the finding that shows that audit fees has negative and significant effect on earnings management of listed DMBs in Nigeria. This is because the board of directors maintained the auditor's remuneration in line with the statutory and professional standard.

ii. Also, the result of the audit tenure which revealed a positive and significant effect on earnings management of listed DMBs in Nigeria; this is because longer audit tenure increases chances of earnings management practice. Thus, it implies that, long-term audit and client relationship enables the management of DMBs in Nigeria to engage in manipulative accounting practice, because long audit tenure can lead to a loss of independence and objectivity as the auditor will be become too familiar with the client and less likely to critically evaluate the client's financial statement.

5.2 Recommendation

i. In line with the first conclusion, the paper recommend among others that, board of directors of DMBs in Nigeria should not deviate from the statutory and professional standard audit fee, as this practice will not influence the auditor's independence in

passing their Professional evaluation of the financial statement's honest and fair view.

ii. The paper recommends that in order to prevent the threat of familiarity, long-term audit company tenure should be discouraged. In addition, financial regulatory authorities such as the Financial Reporting Council of Nigeria should ensure strict compliance of mandatory audit firm rotation within the first five years of engagement as provided by the law if possible. As auditors renewal after the first five years of engagement tends to increase the length of audit firm tenure, thereby giving the room for familiarity which in turn increases the chances of earning management.

DISCLAIMER (ARTIFICIAL INTELLIGENCE)

Author(s) hereby declare that NO generative AI technologies such as Large Language Models (ChatGPT, COPILOT, etc) and text-to-image generators have been used during writing or editing of manuscripts.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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