

Audit Quality and Accrual – Based Earnings Management of Quoted Companies in Nigeria

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Abstract: *This study examines the impact/relationship between audit quality and earnings management represented by companies' discretionary accruals manipulations in Nigeria. Archival data were extracted from annual reports of 57 quoted companies in Nigeria between 2006 and 2011. Audit Firm Size, Audit Fees, Auditor Tenure and Audit Client Importance served as audit quality proxies. The amount of Discretionary Accruals (DAC) was used to measure earnings Management. The results showed that audit quality was significant and negatively related to the amount of DAC of quoted companies in Nigeria. It is recommended in this study that professional accountancy bodies, the Financial Reporting Council of Nigeria and the Nigerian National Assembly should issue authoritative audit quality codes in which auditors' tenure should not exceed three years; companies should improve their earnings quality only through sales growth, and cost control strategies. Also companies in Nigeria should present distinct statements of earnings quality while auditors should conduct earnings quality assessment and issue Integrated Audit Quality Assurance Report by adapting or adopting current best practices statutorily backed by earnings monitoring of companies in Nigeria.*

Key words: *Accounting Scandal, Audit Quality, Discretionary Accruals, Earnings Management, Earnings Quality.*

I. Introduction

Audit quality codes of best practice have been developed in different countries in order to curb the spate of vicious corporate collapses that pervade the globe in the past decade and to guarantee integrity of auditors' reports in relation to corporate earnings. Audit quality defines the market-assessed joint probability that a given auditor discovers a breach in the client's accounting system and reports the breach [1]. Audit quality also depicts the degree to which a set of inherent characteristics of an audit fulfills requirements [3]. The audit of a company's accounts is a monitoring and control mechanism that diminishes information asymmetry and protects the interests of the principal. Thus, the audit process assesses the probability of material misstatements and reduces the possibility of undetected misstatement to an appropriate assurance level [4] [5] [6]. Audit quality influences financial reporting and strongly impact on investors' confidence [7].

Conventionally, external auditors play critical and highly challenging roles in assuring the credibility of financial reports [8], [9]. In the context of these challenges, numerous studies have attempted to establish a more or less marked relationship between audit quality and earnings management and the impact of this relationship on reported earnings of quoted companies in many countries [10], [11], [12]; [13]; [14] [15]. These studies show that the quality of audit is expected to minimize the extent of a firm's manipulations of reported income but majority of the findings are conflicting and contradictory.

Study by Lev shows that the value of a company's shares represents the value of its future earnings [16]. Thus, investors show vital interest in the earnings reports of companies. Earnings Management is a strategy used by company managers to deliberately manipulate company earnings to match a predetermined target and involves the planning and execution of certain activities that manipulate or smooth income, achieve high earnings level and sway the company's stock price [17] [18]. EM is primarily achieved by managed actions that make it easier to achieve desired earnings levels through accounting choices inherent in Generally Accepted Accounting Principles (GAAP). This is commonly occasioned by discretionary accruals manipulations that are likely to present some problems for a true and qualitative earnings report in an emerging market such as the Nigerian Stock Exchange (NSE).

Essentially, agency theory, stakeholder's theory, and auditors' theory of inspired confidence justify the key function of auditing as a mechanism for mitigating information asymmetries among related parties. High auditing quality diminishes information asymmetry and minimizes uncertainty concerning earnings. Therefore, audit quality may be related to earnings management and high audit quality and quality assurance are expected to provide sufficient constraints on Earnings Management.

Evidences concerning the impact of audit quality on earnings management of non-financial institutions exist in developed countries [2], [10], [19], [20], [21] [22], [11]. We are not aware of any existing study relating

to the impacts and association between audit quality and earnings management of quoted companies in the non – financial institutions in Nigeria.

The conflicting results of prior studies require that further studies be done to confirm or refute aspects of extant literature relating to audit quality and earnings management especially in developing economies like Nigeria. This study follows the pattern of the multivariate analyses used, developed and modified by numerous authors between 1998 and 2012 in determining the relationship between audit quality and discretionary accruals management of quoted companies [10], [11] [12] [13] [14] [15].

1.2 Problem Analysis

The quality of reported earnings and the ability of audit quality to effectively constrain earnings management (EM) of companies across the world and Nigeria in particular, have become considerably questionable due to recent corporate accounting scandals [23] [24]. The recent corporate financial scandals pose a great challenge to the veracity, credibility, utility or value relevance of the audit function. Badawi has reported a list of companies involved in cases of accounting scandals related to poor audit quality and earnings manipulations in the US in the past decade [23]. In Nigeria, corporate scandals such as the cases of Cadbury Nigeria Plc and African Petroleum plc [25] Savannah Bank and African International Bank [26]; Wema Bank, Nampak, Finbank and Spring Bank [27] and more recently Intercontinental Bank Plc; Bank PHB; Oceanic Bank Plc. and AfriBank Plc are known publicly reported cases that resulted in misleading financial reports. There is therefore a concern about the quality of accounting income and its relationship with the quality of the auditing process, which has been observed to increase over time following the periodical clusters of business failures, frauds, and litigations. The issue is whether these corporate collapses are not the outcome of poor audit quality and the inability of the audit function to arrest Earnings Management.

EM through DAC is motivated by the need for accounting adjustments and allocations made at the end of a given year for a number of reasons. Usually, accounting for routine exchange transactions does not result in accounting records being properly stated on the accrual basis to make adjusting and allocation entries at the end of the accounting period. The required adjustments are necessitated by the need to ensure that the financial accounts disclose a true picture of the transactions and operations of the organization, as well as comply with GAAP. While the key concept is that GAAP based accounting is supposed to reflect, and not obscure true economic performance, GAAP may also be violated by actions that result or do not result in fraud. GAAP rules are often arbitrary, complicated, and occasionally misleading [28]. GAAP permits many accounting choices and requires much estimation through accruals, deferrals and allocations, thereby facilitating earnings management by companies make innumerable operating and accounting choices and hence engage in some form of earnings management [29].

Knechel [5] posits that the companies that have involved in real accounting scandals greatly involved in transactions where the accounting was technically correct but which served primarily to obfuscate the financial health of the organizations and the results of their operations. Wells reported that widespread manipulation of accounting information and income misstatements through discretionary accruals may be attributable to the pressure on corporate accountants, auditors and organizational managers to show profits [30]. A common trend and threat among the companies that are involved in accounting and financial scandals are gross lack of integrity, character and transactions involving related parties [31], [24] [32].

Drawing from the foregoing analysis, the major problem of this study is to determine whether audit quality can significantly constrain or minimize the negative consequences of earnings management of quoted companies in Nigeria. The study attempts to ascertain and establish whether audit quality exhibits significant impact and relationships with the amount of discretionary accruals of quoted companies in Nigeria.

II. Literature Review

Some prior studies dealing with the relationship between audit quality and earnings management used popular models to test for the impact and relationship between audit quality and earnings management [10] [11] [13] [14] [15]. Becker, Defond, Jiambalvo, and Subramanyam conducted their study in the US business environment using discretionary accrual (DAC) to measure earnings management, focusing on income – increasing DAC and excluded firms that changed the auditor during their test period (1989 – 1992) from the analysis. This led them to note that the major limitation of their analysis was that their model ignored a number of audit quality variables that potentially confound their result [10]. Bauwhede, Willekens, and Gaeremynck posit that audit quality and public ownership act as constraints on income-decreasing EM but not on income-increasing earnings management in Belgium [11]. They estimated discretionary accrual (DAC) following Jones, 1991 model.

Later studies attempt to correct the limitations in Becker, Defond, Jiambalvo, and Subramanyam study of 1998 as well as Bauwhede, Willekens, and Gaeremynck study of 2000 by introducing a number of perceived audit quality attributes into the model and examine the multiple as well as the individual effects of the

identifiable audit quality variables. Heninger, in 2001, provides evidence that the probability of auditor litigation increases as clients report more positive (income-increasing) abnormal accruals [12]. Ebrahim provides additional evidence based on the US environment, using cash flows from operating activities reported in cash flows statement to estimate the total accruals and applied a time series version of the modified Jones, 1991 model to estimate the discretionary accruals [13]. Using a sample of companies listed in NYSE and AMEX, and after controlling for the auditor's tenure and client importance effects, the results provided additional evidence about the negative relationship between audit quality and earnings management behaviours. In estimating the model, Ebrahim controlled for the other audit quality attributes that affect the monitoring efficiency of the auditing process and the absolute value (magnitude) of discretionary accruals. Following Heninger, Ebrahim controlled for the client importance for the auditor (*IMPRT*) as measured by the ratio of the client's sales to the sales of all clients for a given auditor, and the duration of the auditor/client relationship (*TENURE*) [13].

In studying the impact and relationship between audit quality and earnings management in France, Piot and Janin used discretionary accrual as the dependent variable and some identifiable audit quality attributes including audit firm size, audit tenure, and audit committee as explanatory variables along with manager ownership fraction, leverage, board independence, log of total assets, and cash flow from operations [14]. The study regarded multivariate analyses as being necessary to account for the marginal effect of each predictor on earnings management. The result of the study showed that in France, contrary to US studies, Big-5 audited companies do not exhibit a lower level of overall earnings management or a higher degree of conservatism in reported earnings, suggesting that size related audit quality differential does not operate in France with respect to accounting earnings.

In providing evidence from Iran, Gerayli, Yanesari and Ma'atoofi determined the impact and relationship between audit quality and discretionary accruals [15]. They tested for the association between discretionary accruals and audit quality using 540 firm-year observations from Terhan Stock Exchange for fiscal years 2004 – 2009, applied auditor size, auditor industry specialization, and auditor independence as explanatory variables of audit quality taking them together as a multiple measure. The study found that audit quality is negatively associated with earnings management measured by discretionary accruals, indicating that companies which use Big4 auditors in Iran will engage in less earnings management than companies that use non-Big4 audit firms [15].

In Nigeria, the only known study closely related to the present study was conducted in 2012 by Akindayomi who studied "Earnings Management and the Banking Crisis of the 1990s: Evidence from Nigeria" [33]. Akindayomi found that Nigeria banks show a positive association between earnings before taxes and provisions for loan losses, indicating earnings smoothing, and that healthy banks have smoother earnings than distressed ones while distressed banks deliberately understate loan loss provisions to inflate profitability.

III. Methodology

Secondary data obtained from a sample of 57 quoted companies are studied out of the non – financial firms quoted on the NSE over a period of six years from 2006 to 2011 resulting in 342 company accounting – year observations. Archival data were extracted from annual reports and accounts of the selected companies. In this study, amount of discretionary accruals (DAC) is measured as the residual of Jones, 1991 model [34] modified by Dechow, Sloan and Sweeney, 1995 [21] and used by Becker, Defond, Jiambalvo, and Subramanyam, 1998 [10]. The hypothesis of the study applies to the DAC as follows:

H_0 : There is no significant relationship between audit quality and discretionary accruals management of quoted companies in Nigeria;

There appears to be no agreed – upon metric for the measurement of audit quality construct up to the present time. The major proposition of this study is that earnings management depends on audit quality and we maintain that this study extends the audit quality proxy of audit firm size (AFS) to include other perceived proxies. In this study, we estimate audit quality by isolating each of the three most commonly applied surrogates as follows: Audit Firm Size in terms of Big-4 and Non-Big-4 audit firms; Audit Fees which also measures Auditor Independence; Auditor Tenure and Audit Client Importance. We treat the effects of using all the audit quality attributes together. The measurement and construct validity of all the independent variables and the specific review of the various proxies for estimating audit quality are contained in the Table 1 below.

3.1 Model Specifications

The models for testing the effects and presumed relationships between dependent and independent variables considers the most commonly used audit quality proxies. We apply ordinary linear regression analyses to test the relationship between the dependent variable (DAC) and the identified independent audit quality variables. The model is specified as follows:

$$DAC_{i,t} = a_0 + \beta_1 AFS_{i,t} + \beta_2 AF_{i,t} + \beta_3 AT_{i,t} + \beta_4 ACI_{i,t} + \beta_5 CFO_{i,t} + \beta_6 Gwth_{i,t} + \beta_7 CoySize_{i,t} + \beta_8 Lev_{i,t} + e_{i,t} \quad (1)$$

The above equation is used to treat for robustness in order to correct for the effects of the constraints of using single audit quality proxies by applying all the identified perceived audit quality attributes together [12] [13]; [14] [15]. In terms of data analyses techniques, this study used pool and panel data with the application of Least Square (LS) regression analyses. The dependent variables and independent variables were pooled across section and time. Eviews, version 7.0 econometric package was applied to the pooled and panel data from 2006 to 2011 to estimate the model and model coefficients.

The pooled and panel data regression results were complemented by some preliminary statistical analysis including descriptive statistical analysis and correlation. The results obtained from the regression analysis were subjected to some regression diagnostic tests of autocorrelation and Heteroscedasticity. To investigate the existence of multicollinearity, the variance inflation factors (VIFs) for each of the independent variables were computed by examining the OLS assumptions tests for normality; multicollinearity; heteroscedasticity; and autocorrelation.

TABLE 1: Measurement of Variables

S/N	VARIABLES	DEFINITION	TYPE	MEASUREMENT
1	DAC	Discretionary Accruals Management	Dependent	Total Accrual minus Non-Discretionary Accrual
2	AFS	Audit Firm Size	Independent	Dichotomous: '1' if company is audited by a Big4, '0' otherwise
3	AF	A measure of Auditor Independence	„	Natural Log of the Audit Fees Paid by the company.
4	AT	Audit Tenure	„	Length of auditor-client relationship: '1' if 3 yrs+ & '0' if otherwise.
5	ACI	Degree of Audit Client Importance to the Audit Firm	„	% of Turnover of each company to Total Turnover of Clients of the auditor within the sample size
6	CFO	Cash Flow From Operations	Control	CFO as % of Total Assets at end of Year't'.
7	Gwth	Growth Prospects of the Company	„	(Market Value divided by Book Value of Equity) = MPS/BVPS
8	CoySize	Company Size	„	Natural log of company Total Assets
9	Lev.	Leverage	„	$\frac{\text{Total Debts}}{\text{Equity}}$

IV. Data Analyses

TABLE 2: Descriptive Statistics

	Mean	Median	Maximum	Minimum	Std.Dev	Jarque-Bera	Probability
DAC	-1.00E-17	-0.01773	3.068736	-1.58074	0.279332	31907.02	0.000
AFS	0.702771	1	1	0	0.457615	76.42107	0.000
AF	6.821742	6.9	8.22	5.04	0.577794	16.92742	0.000
AT	0.942065	1	1	0	0.233914	3459.362	0.000
ACI	5.536801	1	54.63	0.01	9.839493	1723.826	0.000
CFO	11.66365	11.7	99.49	-126.16	16.67328	3494.981	0.000
GWTH	8.667909	2.7	1228.33	-24.64	72.64753	922498.7	0.000
COSIZE	9.879723	9.97	11.66	7.87	0.790002	10.88827	0.004
LEV	5.505743	1.39	685.82	-15.7	43.15786	696687	0.000

Source: computation derived from Eviews 7.0 by the author

From TABLE 2 the descriptive statistics results show that DAC has a mean value of -1.00E-17 which suggest very minimal DAC value for the sample. The maximum, minimum and median values stood at 3.069 - 0.018 and -1.581 respectively while the standard deviation is 0.279. The Jacque-Bera statistic of 31907.2 alongside its p-value (p=0.00<0.05) indicates that the data satisfies normality and the unlikelihood of outliers in the series.

4.1 Regression Assumptions Tests

Descriptive statistics has revealed that the p-values associated with Jarque-Bera statistics for the variables are all less than 0.05 indicating the normality of data and suitability for generalization. TABLE 3 below presents the regression assumptions tests.

TABLE 3: Regression Assumptions Test (Dependent Variable = DAC)

Variance inflation test for Multicollinearity			
Variable	Coefficient Variance	Centered VIF	
C	0.057367	NA	
AFS	0.001355	1.481751	
AF	0.003418	5.336608	
AT	0.005258	1.140082	
ACI	3.23E-06	1.702803	
CFO	7.93E-07	1.071542	
GWTH	9.18E-08	2.856693	
COSIZE	0.002956	9.567647	
LEV	1.83E-07	2.76272	
Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.125097	Prob. F(1,182)	0.724
Obs*R-squared	0.133254	Prob. Chi-Square(1)	0.7151
Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	1.33545	Prob. F(9,184)	0.2212
Obs*R-squared	11.89525	Prob. Chi-Square(9)	0.2193
Scaled explained SS	96.39948	Prob. Chi-Square(9)	0.3219
Ramsey RESET Test			
Specification: DAC, C, AFS, AF, AT, ACI, CFO, GWTH, COSIZE, LEV			
	Value	Probability	
t-statistic	0.862159	0.3895	
F-statistic	0.743318	0.3895	
Likelihood ratio	0.777317	0.378	

Source: Computation derived from Eview 7.0 by the author

From TABLE 3, none of the variables have VIF's values exceeding 10 and hence none give serious indication of multicollinearity in relation to DAC. The Breusch-pagan-Godfrey test for Heteroscedasticity was performed on the residuals as a precaution. The results showed probabilities in excess of 0.05, which leads us to reject the presence of Heteroscedasticity in the residuals. The Lagrange Multiplier (LM) test for higher order autocorrelation reveals that the hypotheses of zero autocorrelation in the residuals were not rejected. This was because the probabilities (Prob. F, Prob. Chi-Square) were greater than 0.05. The LM test did not therefore reveal serial correlation problems for the model. The performance of the Ramsey RESET test showed high probability values that were greater than 0.05, meaning that there was no significant evidence of misspecification.

4.2 Panel Unit Root Test

In conducting the panel unit root, the Augmented Dickey Fuller (ADF) test was utilized. However, for robustness, we also conduct the unit root using the Breitung t-stat and the Im, Pesaran and Shin W-stat. All tests are conducted at intercept and trend and the results are presented and analyzed below:

TABLE 4 (a): Augmented Dickey Fuller (ADF) Unit Root Test

Null Hypothesis: Unit root (individual unit root process)		
Exogenous variables: Individual effects		
Automatic selection of maximum lags		
Automatic lag length selection based on AIC: 0 to 14		
Method	Statistic	Prob.**
ADF - Fisher Chi-square	570.45	0.000
ADF - Choi Z-stat	-17.2136	0.000

** Probabilities for Fisher tests are computed using an asymptotic Chi-square distribution. All other tests assume asymptotic normality.

TABLE 4(b): Breitung Unit Root Test

Null Hypothesis: Unit root (common unit root process)		
Exogenous variables: Individual effects, individual linear trends		
User-specified maximum lags		
Automatic lag length selection based on AIC: 0 to 3		
Method	Statistic	Prob.**
Breitung t-stat	-7.22855	0.000

TABLE 4(c): Im, Pesaran and Shin unit root test

Null Hypothesis: Unit root (individual unit root process)		
Exogenous variables: Individual effects, individual linear trends		
User-specified maximum lags		
Automatic lag length selection based on AIC: 0 to 3		
Method	Statistic	Prob.**
Im, Pesaran and Shin W-stat	-109.105	0.000

Source: Computation Derived from Eviews 7.0

TABLES 4(a), (b) & (c) above provide summary reports of panel unit root tests on the residuals of the regressions reported in the TABLE 5 below. The p-values reported in Table 4 (a) suggest that the hypothesis of no unit root can be rejected at least at the 5% level. Also, the ADF Fisher statistic (570.45) and the Choi Z-stat. (-17.214) for the stacked residuals indicate that the null hypothesis of non-stationarity is strongly rejected. The Breitung Unit Root Test result shows Breitung t-stat (-7.2286) and p-value (0.00) as presented in table 4 (b) and suggests that the null hypothesis of non-stationarity is strongly rejected at 5%. The Im, Pesaran and Shin unit root test results show Im, Pesaran and Shin W-stat (-109.105) and p-value (0.000) as presented in table 4(c) suggesting that the null hypothesis of non-stationarity is strongly rejected at 5%. With the stationarity condition of the series, the analyses proceed with the conduct of multiple regression analysis with confidence of a high probability of non-spurious regression results.

TABLE 5 below shows the result for Pooled (Stacked) OLS Regression Test Result, Panel OLS (Fixed Effects) Regression Test Result, and Panel OLS (Random effect) Regression Test Result.

TABLE 5: Multiple Regression test (Dependent Variable = DAC)

POOLED OLS			PANEL OLS (FIXED EFFECTS)		PANEL OLS (RANDOM EFFECTS)	
VARIABLE	COEFFICIENT	PROB.	COEFFICIENT	PROB.	COEFFICIENT	PROB
C	-0.023	0.968	0.013	0.965	-1.176	0.000*
EXPLANATORY	VARIABLES					
ACI	-0.001	0.761	-0.001	0.815	-0.014	0.000*
AF	-0.007	0.948	-0.003	0.957	-0.082	0.001*
AFS	0.045	0.487	0.028	0.533	-0.152	0.000*
AT	-0.037	0.235	-0.034	0.645	-0.007	0.613
CONTROL	VARIABLES					
CFO	0.001	0.596	0.001	0.216	-0.001	0.142
GWTH	0.002	0.002*	0.002	0.021*	0.004	0.002*
LEV	-0.025	0.001*	-0.058	0.463	-0.002	0.006*
R ²	0.184		0.184		0.864	
ADJ R ²	0.134		0.146		0.823	
F-Stat	7.202		4.853		21.279	
P(f-stat)	0.000		0.000		0.000	
D.W	2.083		2.09		2.125	
Hausman test	0.54					

Source: Computation derived from Eview 7.0 by the author. * significant at 5% **significant at 10%.

V. Discussion Of Result And Findings

In discussing the results of the variable estimates, preference is placed on the descriptive statistic and Hausman Test. The descriptive statistics show that the mean value of audit firm size is 0.702. This suggests that majority of the companies in the sample were audited by the Big-4 Audit firms. This may be related to the level

of perceived audit firm quality being associated with the use of the Big-4 audit brand names by quoted companies in Nigeria. This result agrees with the findings of previous studies [1], [35], [10], [11], [36]. Other prior studies agree on audit quality as a function of audit firm size and demonstrate that larger (Big 8, Big 6, Big 5 or Big 4) audit firms possess greater capacity to constrain and minimise earnings management through accruals manipulations [37], [38], [39], [40], [41], [42]. Our result shows a considerable cluster of audit firm choice around the Big-4 audit brand names.

The mean value of discretionary accrual (-1.00E-17) suggests a very minimal presence of discretionary accrual manipulation by the sampled companies. This corroborates the evidence in the USA that corporate managers might have shifted away from discretionary accrual management to real earnings management in the post Sarbanes – Oxley Act (SOX) period [43] [44]. This situation appears to be ostensibly replicated in Nigeria, perhaps because of the effects of globalization of World accounting and economic policies, and an anticipation of the adoption of SOX, IFRSs and similar codes of best practices which apparent partial presence is indicated by the promulgation of Financial Reporting Council of Nigeria Act, 2011.

The descriptive statistic revealed that on the average, about 94% of the companies engage their audit firms for over three (3) years. The study reveals a considerable experience of a substantial number of audit firms in this distribution. Audit Tenure is defined in this study as the length of the auditor-client relationship. In Nigeria, it is professionally required that audit tenure should not exceed three years but this does not appear to be enforced.

Using the Panel OLS (fixed effects) estimation result in line with the Hausman test, it is observed that, when we estimate the model using single measure for audit quality, the effect of audit fees on the level of discretionary accruals is positive (0.057) and significant ($p=0.029$) at 5% level. This empirically validates the argument that higher fees may result in the impairment of auditor independence [45] and hence create greater opportunities for accrual manipulations [46] [47] [48], [49]. Some previous studies have shown that larger audit firms receive larger audit fees than smaller audit firms [46], [35], [48]. These prior results show that audit fees are significantly associated with audit quality. However, there appears to be a conflict between this result and some other previous studies especially when audit fees are treated as a measure of auditor independence (AI). In the absence of independence, the value of the audit service is greatly impaired. An auditor's lack of independence increases the possibility of being perceived as not being objective and qualitative. This implies that such auditor may not likely report a discovered breach. Higher fees paid by a company to its external auditors increase the economic bond between the external auditor and the client. Thus, the fees may impair the auditor's independence [45]. In this respect, the result of this study is expected, as the impaired independence leads to poor audit quality, allowing for higher earnings management and poor earnings quality.

The effect of audit firm size as a measure of audit quality on the level of discretionary accruals of quoted companies in Nigeria was found to be negative (-0.138) and significant ($p=0.000$) at 5% level. This is in tandem with our theoretical expectation that the presence of Big-4 Auditors may constrain Earnings Management by minimizing the propensity of corporate managers to manage earnings through the inflation of discretionary accruals of quoted companies in Nigeria. This finding confirms the result of prior research [10], [11], [12], [13], [14] [15].

The effect of auditor tenure on the level of discretionary accruals is negative (-0.021) and significant ($p=0.007$) at 5% level and suggest that longer auditor tenure may also result in less opportunities for accrual management [45] [50]. The auditor expertise hypothesis supports this argument indicating that the auditor learning curve associated with longer tenure may be effective in checking opportunistic behaviours of management.

The degree of audit client importance to the audit firm (ACI) displays a negative (-0.014) and significant (0.000) relationship with discretionary accruals. Empirical evidences confirm the observed relationship between audit client importance and discretionary accruals [13]. Specifically, larger audit clients may try to manage earnings downwards. The test result supports the observations on the basis of panel OLS (Random effects). Audit fees appeared negative (-0.082) and significant at 5% ($p=0.001$) while audit firm size appeared negative (-0.152) and significant at 5% ($p=0.000$).

The findings provide evidence that audit quality measures impact significantly on the level of discretionary accruals. Hence, the null hypothesis (H_0) of a no significant relationship between audit quality and discretionary accruals is rejected. The alternative hypothesis of significant negative relationship between audit quality measures and the amount of discretionary accruals of quoted companies in Nigeria is upheld at 5% level of significance.

5.1 Recommendations

This study recommends that:

1. The management of quoted companies in Nigeria should, as a legal mandate, provide a “statement of the quality of its earnings” arrived at using acceptable and uniform criteria and make assertions that the earnings

of the company have not been manipulated (managed) during the period. Management can be held liable for any misstatement intended to distort or mislead the public with respect to the “quality of earnings”. Management should be responsible for making an assertion about the company’s quality of earnings, similar to the financial statement assertions currently required. Given management’s inherent bias, however, an evaluation of its own quality of earnings would not be viewed by the public as completely reliable.

2. The auditors of quoted companies in Nigeria should conduct Earnings Quality Assessment (EQA) following Earnings Management detection metrics and the techniques enumerated in this thesis and issue “Integrated Audit Reports” which will include EQA reports and Internal Control Reports in addition to normal annual audit reports. EQA reports will provide higher – quality information to financial statement users and meet the Stock Exchange, Regulatory Agencies and the public demand for greater assurance about the reliability of earnings figures. The conduct and completion of the EQA should be a legislative mandate while the auditors should be held responsible for EQA report they issue. Auditors’ insight and expertise in this area is much like the expertise required to evaluate and report on management’s assessment of internal controls under section 404 of the Sarbanes Oxley Act (2002).

3. The three years professional requirement for Auditors in Nigeria should be backed up by law and enforced. Considering the negative effects audit tenure may have on audit quality of independence (measured by audit fee in this study) and in line with global trends, professional accounting bodies, Financial Reporting Council of Nigeria, and the National Assembly should issue a codified and authoritative framework, guideline or standard for auditors’ tenure and independence in Nigeria.

4. Attention should also be focused on companies’ attempts to smooth or increase earnings to beautify its attractions in the stock market through unnecessary manipulation of real economic operations and cash flows. We recommend that companies earn high quality income only through sales growth and cost cutting activities since repeatable and fairly predictable earnings that come from sales and cost reductions presents the company’s earnings as high quality earnings in the eyes of investors.

5. Audit quality measures applied to effectively detect and report earnings misstatements will facilitate the achievement of the public expected low rate of audit failures. This implies that Auditors must plan and perform their audit procedures in a manner that will minimize the risk of an undetected material misstatement. Enhanced annual internal inspections and triennial peer reviews should further compel an enhancement of audit quality in this respect.

6. In order to enhance high Audit Quality and minimize Earnings Management, Companies in Nigeria should adapt to or engage in an outright adoption of currently available best practices like the provisions of US Public Companies Accounting Oversight (Sarbanes Oxley’s) Act, 2002 and Public Companies Accounting Oversight Board standards, the UK Financial Reporting Council’s Audit Quality Guidelines and Frameworks, followed by a statutorily backed earnings monitoring of companies in Nigeria.

5.2 Conclusion

Many past empirical studies investigate the implications of audit quality since the seminal work of DeAngelo in 1981. The majority of these investigations are based on developed economies, while very little is empirically known about the implications, relationships and impact of audit quality on earnings management in emerging or transition economies like Nigeria. This study has examined and documented evidences that are consistent with the relationship and effects which audit quality exerts on earnings management from the perspectives of discretionary accruals manipulations of companies listed on the Nigerian Stock Exchange.

Based on a sample of 342 company – year observations from the NSE for the fiscal years, 2006 to 2011, and using four of the commonly applied audit quality measures (AFS, AF, and AT, ACI) together as perceived audit quality measures, for purpose of robustness, a massive and all-inclusive multivariate analyses was conducted. The result showed that audit quality is significant and negatively related to earnings management measured by discretionary accruals of quoted companies in Nigeria.

Although the results of this study are similar to findings of many similar studies conducted in some more advanced economies, in arriving at the above conclusions, quoted financial institutions, unquoted companies and other firms located within the informal sector of the Nigerian economy were excluded; the sample covered six years of data drawn from annual accounts of sampled companies. The effect of these limitations is that external validity problem may be amplified to constrain the generalization of the results to cover different periods of time and different locations. The effects of inflation on figures related to financial statements, the estimation of discretionary accruals were ignored.

The reported results and findings of this study present obvious implications for regulators such as the Securities and Exchange Commission, Professional Accounting Bodies, Financial Reporting Council of Nigeria, and the National Assembly, in their supervisory position to distinguish between legitimacy, outright fraudulent reporting and earnings statements that reflect the desires of management rather than the underlying performance of the company and to impose appropriate disciplinary penalties on offenders.

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