

Auditors' Attributes and Earnings Management of Listed Insurance Companies in Nigeria

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DOI: [10.56201/ijebm.vol.11.no7.2025.pg195.203](https://doi.org/10.56201/ijebm.vol.11.no7.2025.pg195.203)

Abstract

This study investigates the relationship between auditors' attributes and earnings in a subset of companies listed on the Nigerian Exchange Group. Ex-post facto design was employed and eighteen insurance firms audited annual reports and accounts served as the source of the data. Secondary data on auditors' attributes (audit fee, audit tenure, audit firm size and auditor independence score) and earnings management measure (discretionary accrual) were obtained and computed for the listed insurance companies. Data obtained were analyzed using the ordinary least square regression methodology. Hence, the robustness test was used to evaluate the viability of the tested hypotheses. Additionally, data was subjected to varied regressions using ordinary least square. After data analysis, it was found that audit firm size and earnings management have a positive and substantial association. Additionally, there is a strong and favourable correlation between earnings management, audit fee and auditor independence. The researchers advise supporting large companies since they are adept at reducing the adverse consequences of earnings management, based on the aforementioned observations. In order to create high-quality reports free of profits manipulations, auditor independence should also not be compromised.

Keywords: Auditors independence; Audit fees; Audit size; Earnings management; Insurance
JEL Classification: M14; M42

1. INTRODUCTION

An auditor must adhere rigorously to professional auditing standards and have a reasonable number of the qualitative traits that will allow him to compete favourably in the business world in order to perform his certification job effectively. According to Khadijat, Onipe and Muhammed (2024), regardless of auditor's relationship with the clients - direct or indirect, internal or external, he must maintain a high degree of independence to ensure that they do not compromise or provide unbiased reports. Hence, auditors must possess both technical and functional qualities, including professional competencies, ethical disposition, and educational backgrounds (Ombugu & Udeh, 2023).

The aforementioned attributes enable them to scrutinise and assess the financial statements provided to them by the entity's management for the purpose of formulating an opinion that the users (stakeholders) will rely on to make informed choices. The lack of ethical principles by

Abdullahi (2022), made audit professionals a contributing factor in the audit collapse or debacle failures that occurred on a global scale. Because Worldcom and Enron's internal auditors lacked professional integrity, they misused their notoriety by hiding the truth about their companies' financial situation as it was deteriorating (Abubakar, et al, 2021). Due to these self-interests, the reputation of audit service providers was appallingly misused (Awa & Obinabo, 2020).

According to the Central Bank of Nigeria's 2009 report, Nigeria firms had audit disasters or collapsed during that period. Regarding the financial viability, the external auditors provided unqualified reports. According to Agwor and Onukogu (2018), public, investors, and auditors were all impacted by the audit collapse. The public's confidence in the stock market was damaged as a result of their massive financial losses. Because the auditors' reports were fabricated to simply convince stakeholders that businesses were doing well, they lost their notoriety and the public's trust (Onyabe, et al, 2018; and Yahaya & Awen, 2021).

Furthermore, there is conflicting empirical evidence about the relationship between auditors' attributes and earnings management; some research found favourable results, while others found negative results (Kallamu & Saat, 2015; Manta, 2021). The use of the audit firm size variable was disregarded by researchers in developed countries such as Nigeria. For instance, the size of the audit firm was the sole independent variable employed by Izevbekhai, Odion and Olowoyo (2022). However, audit independence and size were the independent variables considered by Galal, Soliman and Bekheit (2022). In addition to the two variables that these studies utilised, Junaidu and Ahmed (2020) added the audit committee meeting as a third independent variable; this current study aims to close the research gap caused by the auditor independence score and audit tenure exclusions.

The time span of research conducted in the covered area caused another research gap. For example, prior studies covered a four-year period (2007 to 2023). Since a lot of events had already occurred, these eras are a little out of date. The changes made to Nigerian Securities and Exchange Commission's 2011 Corporate Governance Code serve as a prime illustration. The results of the previously described research have been adversely impacted by these alterations, making it impossible to depend on them. Lastly, our study focuses on publicly listed insurance firms from 2015 to 2024, whereas earlier research was either in the banking or conglomerate sectors. Because of these gaps, this study aims to fill them and add to the body of existing knowledge. In light of the aforementioned, this research addressed the following questions: What effect does audit firm size have on earnings management? How has earnings management been impacted by auditor independence score? What effect has audit tenure had on management of earnings? What effect has audit fee had on management of earnings?

2. REVIEW OF RELATED LITERATURE

2.1 Earnings Management

The term "earnings management" has many definitions in the accounting literature. Bala, Amran and Shaari (2019) stated that the terms "creative accounting," "income smoothening," and "accounting numbers game" are interchangeable. According to Bouaziz, Fakhfakh and Jarboui (2020), managers that exert restraint or non-restraint over accounting figures are engaging in earnings management. Care is given to either meet managers' interests or satisfy the wealth (firm value) of the stakeholders. Because earnings management is so broad, these definitions assume that there isn't a single, well recognised definition for the term.

Both inside and beyond Generally Accepted Accounting Principles (GAAP), the debate over what constitutes generally acceptable earnings management is further supported. While

earnings management is legal and acceptable to shareholders when it falls within GAAP's purview, it is unethical and violates all other accepted accounting rules when it does not (Halim, 2021). This study supports the latter claim that earnings management entails manipulating the financial statements through the use of various accounting estimates, techniques, and decisions that contradict GAAP in order to accomplish goals that do not reflect the reporting entity's core economic realities.

Managers are motivated to control reported earnings for a variety of reasons. Increasing share prices, achieving performance-based compensation targets, avoiding debt covenant violations, and manipulating earnings around equity offerings like initial public offerings (IPOs) and seasoned equity offerings (SEO) are some of the reasons for earnings manipulation, according to the literature currently in publication (Namakavarani, et al, 2021). Although there are many explanations for earnings management, these were divided into four primary categories. These include loan arrangements, capital market incentives, management compensation contracts, and incentives related to political and regulatory needs (Timea, 2019).

The challenge of easily identifying manipulations in the publicly available financial statements has existed over time. To quantify earnings management, numerous accounting models have been developed. Some authors utilise anomalous or discretionary accrual as a stand-in for earnings management (Williamson & Akpomedaye, 2021). The Jones model, industry model, DeAngelo model, Healey model, and modified Jones model are a few of the models that have been developed. The modified Jones model (1995), out of all these models, is the most popular and well recognised in accounting empirical literature as the most effective way to examine earnings management.

2.2 Auditors' Attributes

Abdullahi (2022) asserts that audit quality gauges how much the general public or auditors' clients anticipate them to notify the company's management of any mistakes, irregularities, or financial misstatements found in audited financial statements. These traits may be utilitarian or technical in nature. While functional qualities focus on how audit process, procedure, methods, and audit empathy are geared towards meeting the expectations of the clients, technical aspects are concerned with meeting the clients' expectations in reporting inherent errors and irregularities in the proposed financial statements in order to satisfy the user's needs (Halim, 2021).

First, when it comes to reporting on audited financial statements, an auditor's independence encompasses all decisions they make without outside influence. It involves the auditor's mental acuity when making choices regarding the financial reporting procedure and the audit exercise (Izevbekhai et al, 2022; Junaidu & Ahmed, 2020). To be independent, an auditor must not be swayed, convinced, or biased in their delivery of audit services, according to Khadijat, et al (2024). In a related issue, Manta (2021) suggested that the large charge paid by the client could compromise the independence of the auditor because the customer's economic bond rises or falls in proportion to the high fee they receive.

According to Namakavarani, et al (2021), when audit quality is reduced due to a compromise in auditor independence, the stock market experiences certain setbacks. The widespread audit collapse seen worldwide raised serious concerns about auditor independence. Because it increases investor confidence in the published financial statements and validates their neutrality, auditor independence is essential to the reliability of published financial statements (Ombugu & Udeh, 2023). According to the auditors' report, Onyabe et al (2018) found a

positive significant relationship between auditor independence and earnings management. This is because an independent auditor's judgements are more trustworthy, pertinent, and objective, making earnings management more difficult to occur.

In their research in Nigeria, Yahaya and Awe (2021) found that the largest obstacle preventing Nigerian auditors from being independent is the level of their audit fees. As noted by Yahaya and Onyabe (2022), the independence of Nigerian auditors is threatened by audit and non-audit fees. Additionally, they conducted a study on the joint provision of audit and non-audit services and found that the provision of non-audit services unquestionably reduces the independence of auditors.

2.3 Theoretical Framework

The relationship between the auditors' attributes and earnings management is explained by this study using the agency theory. Berle and Means's (1932) as cited in Bala et al (2019) work served as the foundation for agency theory. These academics investigated the idea of agency and its applicability to the growth of big businesses. In order to explain the origin of those conflicts, the researchers used the ideas of agency and principal to determine how the interests of the directors and managers differ from those of the firm's owners.

Building on the work of Berle and Means (1932), Jensen and Meckling (1976) developed agency theory as a formal term. Since efficiency and effectiveness are inextricably linked, there will always be some degree of goal conflict between the parties. As a result, information between the principal and the agent will always be somewhat asymmetrical (Bouaziz, et al, 2020). Therefore, the contractual arrangement between two or more individuals known as the agent(s) to carry out certain activities on behalf of the principal is the focus of agency theory (Galal, et al, 2022).

Furthermore, it is assumed that the principal and the agents entered into a contract or mutual agreement driven only by self-interest. Agents are tasked by the principal with making decisions (Timea, 2019). It is a theory that clarifies why members of a group display different choices or behaviours. In particular, it explains the interaction between a principle and an agent, who assign tasks to each other (Awa & Obinabo, 2020). It notes that the two parties frequently have distinct aims and, regardless of their individual goals, different attitudes towards risk, which helps to explain why they behave or make different judgements (Agwor & Onukogu, 2018).

It is always expected that the decisions made by the agents will affect both parties. Achraf, El-Ammari, and Bouri (2021) claimed that these linkages are seen in business and economic life and also lead to more issues with contracts between economic entities. This indicates a contractual arrangement between the audit committee and external auditors, or between the audit committee and shareholders, and between directors and shareholders (Abubakar, et al, 2021; and Williamson & Akpomedaye, 2021).

3. METHDOOLOGY

This study's research design used is the ex-post facto involving panel data. The time-frame for this investigation was from 2015-2024 and these periods were chosen to accomplish the study's stated goals. However, eight publicly listed insurance companies on the Nigerian Exchange Group (NGX) were obtained via the judgemental sampling technique. The multiple linear regression estimates was used in ascertaining the effect of auditors' attributes on earnings management.

Auditors' attributes were the independent variables (measured by natural logarithm of audit fees, audit tenure, audit firm size, and auditors' independence score) while the dependent variable is earnings management (measured by discretionary accruals). Given the dependent and independent variables of the study, the following empirical models were estimated:

$$DA = F(\ln \text{AudFee}, \text{AudTen}, \text{AudFSize}, \text{AudIndSco}) \quad \text{-Eq. 1}$$

$$DA_{it} = \beta_0 + \beta_1 \ln \text{AudFee}_{it} + \beta_2 \text{AudTen}_{it} + \beta_3 \text{AudFSize}_{it} + \beta_4 \text{AudIndSco}_{it} + \varepsilon_{it} \quad \text{-Eq. 2}$$

Where: DA is discretionary accrual (a measure of earnings management); $\ln \text{AudFee}$ is natural logarithm of audit fees, AudTen is audit tenure, AudFSize is audit firm size (measured using dummy variable: 1 if audited by Big-4 Auditors and zero if otherwise), AudIndSco is auditor independence score. A-priori expectation is that auditors' attributes will significantly affect earnings management. STATA 16.0 statistical software was employed in carrying out the data analysis.

4. RESULTS

Table 1: Descriptive Statistics Result

Parameters	Da	$\ln \text{AudFee}$	AudTen	AudFSize	AudIndSco
Mean	-0.0052	1.6758	5.0000	0.3750	0.6873
Maximum	0.0926	1.9989	9.0000	1.0000	0.4000
Minimum	-0.0980	1.0881	1.0000	0.0000	0.9800
Standard Deviation	0.0455	0.2389	2.6001	0.4875	0.1537
Skewness	0.0174	-0.5628	1.0000	0.5163	-0.1120
Kurtosis	2.4078	2.4159	1.7700	1.2666	2.0753
Observations	72	72	72	72	72

Source: Researchers Computation via STATA 16.0

From Table 1, it can be seen that the independent variable ($\ln \text{AudFee}$, AudTen , AudFSize , and AudIndSco) showed positive mean values due to the improvements in financial reporting in the period investigated except the dependent variable (Da - discretionary accrual); this is expected. The standard deviations range from 0.0455 (Da) and 2.6001 (AudTen); however, the dependent and independent variables did not displayed non-zero skewness. Also, all the variables were positively skewed as shown in the positive signs attached to variables of the study except $\ln \text{AudFee}$. In addition, all the variables have normal distribution as revealed in the kurtosis values, which were closer to three (3); an indicates that the datasets are suitable in carrying statistical inferences.

Table 2: Pearson Correlation Result

Parameters	Da	$\ln \text{AudFee}$	AudTen	AudFSize	AudIndSco
Da	1.0000				
$\ln \text{AudFee}$	-0.1446	1.0000			
AudTen	-0.0709	0.0900	1.0000		
AudFSize	0.0312	-0.1901	0.0000	1.0000	
AudIndSco	0.0774	-0.0448	-0.0014	0.7085	1.0000
Observations	72	72	72	72	72

Source: Researchers Computation via STATA 16.0

Table 2 is the Pearson correlation result; coefficient of auditors attributes (AudFSize and AudIndScore) were positive, indicating that audit firm size and auditor independence score

moved together with discretionary accruals (Da) while the other auditors attribute (InAudFee, and AudTen) were negative, suggesting that they moved in the opposite direction with Da. Furthermore, the highest correlation coefficient (.7085) is between AudFSize and AudIndSco; however did not beat the maximum threshold of 0.80, suggesting absence of multicollinearity among pairs of the independent variables of the study.

Table 3: Variance Inflation Factor Result

Variables	VIF	1/VIF
InAudFee	1.06	0.939481
AudTen	1.01	0.991404
AudFSize	2.12	0.472662
AudIndSco	2.04	0.489553
Mean VIF	1.56	

Source: Researchers' Computation via STATA 16.0

Table 3 showed the regression diagnostic results; the Mean VIF is 1.56 and is less than the benchmark mean VIF of 10, this implies an absence of multicollinearity in empirical model of auditors' attributes and earnings management.

Table 4: Ordinary Least Square (OLS) Result

					No. of Obs.	=	72
					F (4, 67):	=	58.00
					Prob. > F:	=	0.0000
					R-squared:	=	0.7300
					Root MSE	=	0.4605
Da	Coef.	Std. Error	t	t/			
InAudFe	-0.0288	0.0235	-3.22	0.001			
AudTen	-0.0997	0.0021	-4.77	0.000			
AudFSize	0.0891	0.0160	5.50	0.000			
AudIndSco	0.4048	0.0507	8.01	0.000			
Constant	0.0233	0.0483	12.48	0.000			

Source: Researchers Computation via STATA 16.0

Presented in Table 4 is the regression result of auditor attributes (InAudFe, AudTen, AudFSize, and AudIndSco), and earnings management (Da). The R^2 is 0.7300, indicating that auditors' attributes explained about 73% of the systematic variation in earnings management. This implies that there are few other variables that may explain earnings management which were not included in the empirical model. Also, the coefficients of auditors' attributes were statistically significant; this implies that auditors' attributes significantly influence earnings management. Overall, the F-ratio (4, 67= 58.0; p-value=0.000 < 0.05) revealed that auditors' attributes has significant effect on the level of earnings management of the publicly listed insurance companies in Nigeria.

5. CONCLUSION AND RECOMMENDATIONS

The purpose of the study was to investigate the relationship between auditors' attributes and earnings management of publicly listed insurance companies in Nigeria. In light of this, our findings demonstrate that size of audit firms has a major influence on earnings management. Earnings management is also significantly impacted by audit tenure and audit fee. Lastly, there is a positive correlation between earnings management and auditors' independence score. In

light of the study's results/conclusion drawn, it was recommended that companies under the researchers' review should work to keep or grow their businesses to a sizeable size because this will allow them to keep an eye on management's actions and establish a robust internal control system and governance framework that will assist them in minimising or reducing earnings management practices.

Furthermore, regulatory frameworks and organizations that oversee accounting and auditing procedures in Nigeria should make sure that auditors' independence is maintained since it has been discovered that maintaining auditors' independence significantly lowers earnings management. Additionally, an auditor's employment should not exceed three years in order to prevent the familiarity danger; otherwise, auditor independence may be jeopardised, which could result in subpar financial reports. Based on the study's findings, we advise against increasing auditors fees since it prevents them from showcasing their professionalism and knowledge and quickly comprise their audit function or role; this will assist auditors to reduce earnings management methods because their reputation and name would be on the line because their established reputation will be influenced by jealousy.

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