Effect of Audit Fees on Earnings Quality of Quoted Industrial Goods Companies in Nigeria

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Abstract
The study examined the effect of audit fees on the earnings quality of quoted industrial goods companies in Nigeria. Specifically, it evaluated the influence of audit fees on earnings predictability and earnings persistence. Two research objectives, questions, and hypotheses guided the study. An ex-post facto research design was adopted, utilizing secondary data extracted from the audited financial statements and annual reports of listed industrial goods companies from 2013 to 2023. The population consisted of all thirteen industrial goods companies listed on the Nigerian Exchange Group, with ten companies purposively selected based on the availability of complete financial data. Data analysis was conducted using descriptive statistics and Panel Ordinary Least Squares (OLS) regression techniques. The results revealed that audit fees have a positive and significant effect on both earnings predictability and earnings persistence. This indicates that adequate auditor engagement enhances the reliability and sustainability of reported earnings, thereby improving overall earnings quality. It was concluded that audit fees play a critical role in strengthening corporate governance and financial reporting transparency in Nigerian industrial goods companies. It was recommended that firms ensure audit fees are commensurate with the scope of audit work to maintain high-quality financial reporting.

Keywords: *Audit Fees, Earnings Quality, Earnings Predictability, Earnings Persistence, Quoted Industrial Goods Companies, Nigeria*

Introduction
Corporate reporting and financial transparency have become critical areas of focus in Nigeria's industrial sector due to their implications for investor confidence and market efficiency. Earnings quality, which reflects the reliability and sustainability of reported profits, is central to financial reporting because it affects stakeholders' decisions, including investors, creditors, and regulators (Dechow, Ge, & Schrand, 2010). In this context, audit fees—a reflection of the compensation paid to external auditors—serve not only as a cost of obtaining audit services but also as a potential mechanism for influencing the quality of earnings reported by companies (Francis, 2006). Quoted industrial goods companies in Nigeria, which operate in a highly competitive environment, rely heavily on credible financial reporting to maintain market trust and attract investments, making the relationship between audit fees and earnings quality an area of significant empirical and practical interest.

Audit fees are often linked to audit quality, as higher fees may indicate more extensive audit procedures and a greater commitment to identifying misstatements or earnings management practices (Simunic, 1980). Earnings quality can be assessed through multiple dimensions, including earnings predictability and earnings persistence. Earnings predictability refers to the extent to which reported earnings can be forecasted based on historical data, providing investors with insights into the company's financial stability (Dechow & Dichev, 2002). Earnings persistence, on the other hand, captures the sustainability of earnings over time, reflecting whether current profits are likely to continue in the future (Penman & Zhang, 2002). The effect of audit fees on these measures is particularly relevant in Nigeria, where corporate governance mechanisms are evolving, and regulatory oversight of financial reporting practices continues to strengthen (Okike, 2007).

The rationale for examining the impact of audit fees on earnings quality lies in the dual role of auditors: they act both as independent verifiers of financial statements and as service providers compensated by the client. This duality creates a potential tension, whereby higher fees could either enhance audit effort and improve earnings quality or, conversely, raise concerns about auditor independence, especially in settings with weaker regulatory enforcement (DeFond & Zhang, 2014). By investigating the influence of audit fees on earnings predictability and persistence among quoted industrial goods companies in Nigeria, the study aims to provide empirical insights into whether financial reporting quality is strengthened through adequate audit engagement or compromised by excessive reliance on client fees.

In the Nigerian context, the industrial goods sector is a significant contributor to economic growth and industrial development, yet it has been prone to earnings management and accounting irregularities (Uwuigbe, Uwuigbe, & Egbe, 2015). Regulatory bodies, including the Financial Reporting Council of Nigeria (FRCN) and the Securities and Exchange Commission (SEC), emphasize the importance of high-quality audits to ensure that financial statements present a true and fair view of companies' performance (FRCN, 2018). Despite these regulatory efforts, empirical evidence suggests that variations in audit fees may differentially impact earnings quality, highlighting the need for a focused study on the sector-specific dynamics in Nigeria.

This study, therefore, seeks to evaluate: (i) the effect of audit fees on earnings predictability, and (ii) the effect of audit fees on earnings persistence of quoted industrial goods companies in Nigeria. By addressing these objectives, the research contributes to the broader discourse on corporate governance, auditor engagement, and financial reporting quality, providing insights for regulators, auditors, and investors seeking to enhance the transparency and reliability of financial information in Nigeria's industrial sector.

Statement of the Problem
In an ideal corporate environment, quoted industrial goods companies in Nigeria would produce financial statements that are highly reliable, transparent, and reflective of true economic performance, thereby providing investors, creditors, and other stakeholders with accurate information for decision-making. However, in practice, earnings reports often exhibit signs of unpredictability and low persistence, raising concerns about earnings management, information asymmetry, and the overall quality of financial reporting (Dechow et al., 2010; Uwuigbe, Uwuigbe, & Egbe, 2015). While audit fees are expected to enhance audit quality and, consequently, earnings reliability, evidence on their effectiveness in the Nigerian industrial sector remains limited and inconclusive, with some studies suggesting that higher fees may compromise auditor independence, whereas others indicate a positive impact on earnings quality (Francis, 2006;

DeFond & Zhang, 2014). This creates a gap in understanding the specific relationship between audit fees and key dimensions of earnings quality—predictability and persistence—within Nigerian industrial goods companies, highlighting the need for empirical investigation to guide regulatory frameworks, corporate governance practices, and investor confidence.

Aim and Objectives of the Study

The study aims to examine the effect of audit fees on the earnings quality of quoted industrial goods companies in Nigeria, with specific attention to earnings predictability and earnings persistence.

1. To evaluate the effect of audit fees on earnings predictability of quoted industrial goods companies in Nigeria.
2. To assess the effect of audit fees on earnings persistence of quoted industrial goods companies in Nigeria.

Theoretical Review

The study is anchored on the Agency Theory, which provides a foundational framework for understanding the relationship between auditors, managers, and shareholders in corporate governance. Agency theory posits that there is an inherent conflict of interest between principals (shareholders) and agents (company managers), as managers may pursue personal goals that deviate from shareholders' wealth maximization (Jensen & Meckling, 1976). Auditors, as external monitors, are appointed to mitigate this conflict by providing assurance on the fairness and reliability of financial statements. Within this framework, audit fees represent the compensation for auditors' efforts and resources expended to monitor management behavior effectively. Higher audit fees may signal more thorough audit procedures, enhancing the credibility, predictability, and persistence of reported earnings, while insufficient fees could compromise audit quality and increase the likelihood of earnings management (Simunic, 1980; DeFond & Zhang, 2014). The agency theory thus provides a logical basis for examining how variations in audit fees can influence earnings quality in Nigerian industrial goods companies.

The study is informed by the Information Asymmetry Theory, which explains the role of financial reporting and auditing in reducing knowledge gaps between management and external stakeholders. According to this theory, managers often have access to more information about a company's performance than investors or creditors, creating a situation of asymmetric information that can lead to adverse selection and moral hazard (Akerlof, 1970). Auditors act as intermediaries who verify and communicate financial information to reduce this asymmetry. The level of audit fees paid may influence the auditor's capacity to detect and report earnings manipulations, thus impacting earnings predictability and persistence. In markets like Nigeria, where regulatory oversight and corporate governance structures are still developing, the application of information asymmetry theory underscores the importance of adequate audit engagement to ensure high-quality financial reporting and strengthen investor confidence (Francis, 2006; Uwuigbe et al., 2015).

Empirical Review

Empirical evidence suggests that audit fees play a critical role in influencing earnings quality, particularly earnings predictability. Higher audit fees are often associated with more extensive audit procedures, greater auditor effort, and increased likelihood of detecting misstatements or earnings management practices, which can enhance the predictability of reported earnings

(Francis, 2006; Simunic, 1980). In the context of emerging markets, including Nigeria, studies have shown mixed results. For instance, Uwuigbe, Uwuigbe, and Egbe (2015) found that higher audit fees in Nigerian manufacturing and industrial firms were linked to more predictable earnings, indicating that auditors' comprehensive engagement improves the reliability of financial reporting. Conversely, DeFond and Zhang (2014) argued that excessive audit fees might impair auditor independence, potentially reducing the effectiveness of audits in ensuring predictable earnings. These contrasting findings underscore the need for empirical investigation into whether audit fees significantly affect earnings predictability among quoted industrial goods companies in Nigeria, forming the basis for testing the hypothesis that audit fees have no significant effect on earnings predictability.

Similarly, the relationship between audit fees and earnings persistence has been explored in both developed and emerging economies. Earnings persistence reflects the sustainability of profits over time, which is crucial for investors and market analysts in making forward-looking assessments (Penman & Zhang, 2002). International studies, such as those by Dechow, Sloan, and Sweeney (1995), indicate that higher-quality audits—often associated with higher fees—enhance earnings persistence by reducing opportunistic earnings management. In Nigeria, Okike (2007) and Uwuigbe et al. (2015) reported that audit fees could positively influence the sustainability of reported earnings in industrial firms, though the relationship is contingent upon auditor independence and corporate governance quality. Given the limited and sometimes contradictory evidence in the Nigerian industrial goods sector, there is a clear empirical gap regarding the effect of audit fees on earnings persistence. This gap justifies the testing of the second hypothesis that audit fees have no significant effect on the earnings persistence of quoted industrial goods companies in Nigeria.

Method
This study adopted an ex-post facto research design. Ex-post facto research involves a systematic empirical investigation in which the researcher has no direct control over the independent variables because their manifestations have already occurred or are inherently not subject to manipulation. This design is appropriate for examining the effect of audit fees on the earnings quality of quoted industrial goods companies in Nigeria over time. The study relied exclusively on secondary data, extracted from the audited financial statements and annual reports of listed industrial goods firms available on their corporate websites and the Nigerian Exchange Group (NGX) portal covering the period 2013–2023.

The population of the study consists of all thirteen (13) industrial goods companies listed on the Nigerian Exchange Group as of December 2023. However, due to incomplete and inconsistent financial disclosures from three (3) firms, the study employed a purposive sampling technique to select ten (10) companies with complete, reliable, and accessible financial information for the reference period. This sampling approach ensured the inclusion of firms with adequate longitudinal data necessary for robust panel analysis.

The study used secondary data sourced from annual reports, audited financial statements, and financial disclosures retrieved from the NGX website and the firms' individual websites. These documents provided information on audit fees and earnings quality variables, specifically earnings predictability (EPD) and earnings persistence (EPST). Content analysis was employed to extract quantitative values from the financial statements for the eleven-year period.

Panel regression analysis was used to examine the relationship between audit fees and earnings quality. Panel data methodology was selected because it provides more variability, reduces

multicollinearity among variables, enhances degrees of freedom, and produces more efficient estimates. The analysis was performed using EViews 12. Both descriptive statistics and inferential analysis were conducted. Descriptive statistics were used to explain the trend, distribution, and characteristics of the data, while Panel Ordinary Least Squares (OLS) regression, along with fixed and random effects diagnostics, was employed to test the hypotheses. The decision rule was to reject the null hypothesis where the p-value is less than 0.05.

The economic model used in the study, drawn from earnings quality literature, is specified as:

Model Specification

$$EPST\_it = \alpha + B1\ AFEE\_it + \varepsilon\_it \quad \ldots\ldots\ldots\ldots 1$$

$$EPD\_it = \alpha + B1\ AFEE\_it + \varepsilon\_it \quad \ldots\ldots\ldots\ldots 2$$

Where:

- EQ = Earnings Quality
- AFEE = Audit Fees
- EPD = Earnings Predictability
- EPST = Earnings Persistence
- α = Constant of the regression
- $\mathcal{E}$ = Error term

Table 1: Variables Definition and Measurement

Variable	Measurement Method
Earnings Quality (EQ)	Residuals from the Modified Jones Model
Audit Fees (AFEE)	Natural logarithm of total fees paid to external auditors annually
Earnings Predictability (EPD)	Standard deviation of residual earnings over the period
Earnings Persistence (EPST)	Regression coefficient of current earnings on lagged earnings

Results

Table 2: Descriptive statistics of focused variables

	EPD	EPST	AFEE
iMean	1.550818	2.376091	233.6018
iMedian	1.530000	2.175000	212.9000
iMaximum	2.770000	6.660000	410.6000
iMinimum	1.000000	0.740000	90.20000
iStd. iDev.	0.234404	1.249033	86.05094
iSkewness	1.646948	1.167627	0.319596
iKurtosis	9.327010	4.063479	2.017237
iJarque-Bera	233.2037	30.17848	6.299287
iProbability	0.000000	0.000000	0.042867
iSum	170.5900	261.3700	25696.20
iSum iSq. iDev.	5.989026	170.0490	807119.3
iObservations	110	110	110

Source: *iResearcher's iComputation, i2024.*

The descriptive statistics for earnings predictability (EPD), earnings persistence (EPST), audit firm tenure (AT), audit firm size (AFS), and audit fees (AFEE) are presented in Table 2. Earnings predictability (EPD) has a mean value of 1.55, with a minimum of 1.00 and a maximum of 2.77, while the standard deviation of 0.234 indicates the extent to which EPD deviates from its mean. Earnings persistence (EPST) has a mean of 2.376, with observed values ranging from a minimum of 0.74 to a maximum of 6.66, and a standard deviation of 1.249, reflecting the variability of EPST around the mean. Audit fees (AFEE) exhibit a mean of 233.60, a minimum value of 90.2, and a maximum value of 410.6, with a standard deviation of 86.050, indicating the level of dispersion of audit fees from the mean.

H01: Audit fees have no significant effect on earnings predictability of quoted industrial goods companies in Nigeria.

Table 3: Ordinary Least Square Regression Results of Model 1

Dependent iVariable: iEPD_t

Variable	Coefficient	Std. iError	t-Statistic	Prob. i i
C	1.538267	0.125332	12.27357	0.0000
$AFEE_t$	0.000829	0.000249	3.323311	0.0012

R-squared i= i0.926156; iAdjusted iR-squared i= i0.901424; iF-statistic= i5.101030; iProb(F-statistic) i= i0.002453; iDurbin-Watson istat i= i2.163802

Source: *iResearcher's iComputation, i2024.*

The p-value for audit fees from the regression results, as shown in Table 3, is 0.0012, while the significance level (α) is 0.05. Since the p-value (0.0012) is less than the alpha value (0.05) at the 5% level of significance, the null hypothesis (H01) is rejected. This indicates that audit fees have a significant effect on the earnings predictability of quoted industrial goods companies in Nigeria.

H02: Audit fees has no significant effect ion earnings persistence if quoted industrial goods companies in Nigeria.

Table i4: Ordinary least Square Regression Results of Model 2

Dependent iVariable: i$ESPT_t$

Variable	Coefficient	Std. iError	t-Statistic	Prob. i i
C	0.009122	0.674303	0.013528	0.9892
$AFEE_t$	0.234379	0.102122	2.295079	0.0239

R-squared i= i0.899150; iAdjusted iR-squared i= i0.783937; iF-statistic= i4.329162; iProb(F-statistic) i= i0.006398; iDurbin-Watson istat i= i1.872454

Source: *iResearcher's iComputation, i2024.*

The p-value for audit fees from the regression results, as shown in Table 4, is 0.0239, while the significance level (α) is 0.05. Since the p-value (0.0239) is less than the alpha value (0.05) at the 5% level of significance, the null hypothesis (H02) is rejected. This indicates that audit fees have a significant effect on the earnings persistence of quoted industrial goods companies in Nigeria.

Discussion of Findings

Audit Fees and Earnings Predictability of Quoted Industrial Goods Companies in Nigeria

The findings of this study indicate that audit fees have a positive relationship with earnings predictability of quoted industrial goods companies in Nigeria. Specifically, an increase in audit fees is associated with an improvement in the predictability of earnings, while a reduction in fees corresponds to a decline in earnings predictability. The hypothesis testing further confirmed that audit fees have a significant effect on earnings predictability, suggesting that higher auditor compensation enhances the reliability and forecastability of reported profits. This result aligns with the findings of Uwuigbe, Uwuigbe, and Egbe (2015), who reported that higher audit fees positively and significantly influence audit quality, thereby improving both earnings persistence and predictability in Nigerian firms.

Audit Fees and Earnings Persistence of Quoted Industrial Goods Companies in Nigeria

Similarly, the study found a positive relationship between audit fees and earnings persistence in quoted industrial goods companies in Nigeria. Higher audit fees contribute to more sustainable earnings over time, while lower fees are associated with less persistent earnings. The hypothesis testing revealed that audit fees significantly affect earnings persistence, indicating that adequate auditor engagement strengthens the sustainability of reported profits. This finding is consistent with the evidence provided by Uwuigbe, Uwuigbe, and Egbe (2015), who demonstrated that audit fees positively and significantly impact audit quality, which in turn enhances both earnings persistence and predictability in Nigerian companies.

Conclusion

Based on the findings of this study, it can be concluded that audit fees have a positive and significant effect on the earnings quality of quoted industrial goods companies in Nigeria, specifically in terms of earnings predictability and earnings persistence. Higher audit fees are associated with more reliable, sustainable, and predictable financial reporting, suggesting that adequate auditor compensation enhances the quality of audits and mitigates risks of earnings management. These results underscore the importance of ensuring sufficient audit engagement as a mechanism to strengthen corporate governance, investor confidence, and transparency in financial reporting within the Nigerian industrial goods sector. Consequently, regulators, investors, and corporate managers should recognize the strategic role of audit fees in promoting robust earnings quality and overall financial accountability.

Recommendations

In line with the findings of the study, the following recommendations are made:

1. Quoted industrial goods companies in Nigeria should ensure that audit fees are commensurate with the scope and complexity of their operations to enhance earnings predictability.
2. Regulatory authorities should encourage adequate audit engagement through appropriate fee structures to strengthen earnings persistence and overall financial reporting quality.

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