
EARNINGS MANAGEMENT AND AUDIT FEES OF INDUSTRIAL GOODS COMPANIES

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ABSTRACT: *This study looked into the relationship between audit fees and earnings management in Nigerian industrial goods companies. Using secondary data from the audited annual reports of the 12 listed industrial products businesses for the years 2020–2024, an ex post facto research design was used. The firm size was calculated using the natural logarithm of total assets, audit fees were represented by reported audit expenses, and accrual quality was used to evaluate earnings management. The study data was summarised using descriptive statistics, but substantial cross-sectional effects were found using the Lagrange Multiplier test, which made the use of a random effects model for analysis necessary. Poor accrual quality is associated with higher audit charges, according to the correlation data, which revealed a strong negative relationship between accrual quality and audit fees ($r = -0.534$, $p = 0.015$). Furthermore, it was discovered that firm size moderated the association between accrual quality and audit fees and showed a strong positive relationship with audit fees ($r = 0.890$, $p < 0.001$), suggesting that larger firms pay higher audit fees regardless of accrual quality. Overall, the study finds that firm size and earnings management strategies have a big impact on how much audit fees are charged in the industrial goods sector.*

KEYWORDS: Earnings Management, Accrual Quality, Audit Fees, Firm Size

1. INTRODUCTION

In corporate finance, appearances can be deceiving due to its intricate and frequently opaque nature. Businesses are constantly under pressure to show positive financial performance, usually striking a balance between subtle manipulation and true transparency (Bushman & Landsman, 2019). Earnings management is a key instrument in this context, when financial statements are purposefully changed to accomplish particular goals, occasionally compromising actual financial accuracy (Healy & Wahlen, 1999; Dechow et al., 2010). Audit fees, which are the compensation given to auditors for examining financial documents, are closely associated with this activity. More recently, it has been demonstrated that audit fees, which are often thought of as measures of audit difficulty, have a major impact on the independence, quality, and intensity of audits (Carcello et al., 2011; Knechel et al., 2013). Higher fees might allow auditors to devote more time and resources, but they could also lead to conflicts of interest if they account for a sizable amount of the auditor's income from a certain client (Chen et al., 2010).

There is a complicated and far from simple relationship between audit fees and earnings management. Increased audit fees may enhance audit quality and prevent earnings manipulation, according to certain study (Francis et al., 2005). However, there is evidence that large fees can potentially undermine the independence of auditors, which in turn can lead to more aggressive earnings management (Raghunandan & Rama, 2017). This dichotomy emphasises how context-specific and complex audit effectiveness is. This dynamic is further complicated by broader economic factors. Businesses are frequently more likely to manipulate earnings during unstable or volatile market times, which increases the influence of audit fees on audit results (Defond & Zhang, 2014). As a result, regulatory frameworks, auditor-client contacts, and current market forces must all be taken into account for a thorough understanding of this relationship.

Important gaps still exist despite a growing corpus of literature, particularly in emerging markets where financial reporting contexts diverge significantly from those in industrialised economies. Higher audit fees may erode auditor independence and facilitate earnings management, according to some research, while other studies have identified a correlation between stronger audits and less profits manipulation (Francis et al., 2005; Raghunandan & Rama, 2017). The paucity of empirical data in emerging economies, especially in Nigeria's industrial products sector, exacerbates this discrepancy. Therefore, more research is required to evaluate the impact of audit fees on earnings management techniques in industrial goods companies in Nigeria.

Hypotheses

Ho1: There is a significant relationship between accrual quality and audit fees of industrial goods companies in Nigeria.

Ho2: Firm size significantly moderates the relationship between accrual quality and audit fees of industrial goods companies in Nigeria.

2. LITERATURE REVIEW

Earning Management

The intentional manipulation of a company's financial statements by its management to accomplish particular goals, frequently to sway stakeholders' opinions about the company's financial health, is known as earnings management (Healy & Wahlen, 1999). The deliberate modification of reported earnings to satisfy internal or external benchmarks, legal constraints, or market expectations—which may or may not represent the firm's underlying economic reality—is referred to as earnings management in the context of this study. According to Dechow et al. (2010), managers may manipulate earnings in order to affect stock prices, fulfil debt covenants, or accomplish bonus-related goals. These activities include using accounting rules that have the potential to inflate or deflate earnings, as well as strategically timing revenues and expenses. Earnings management is essentially a reflection of the conflict between managerial goals to achieve desired financial results and accurate financial reporting (Schipper, 1989).

Real earnings management and accrual-based earnings management are the two basic categories into which earnings management may be divided (Roychowdhury, 2006). The manipulation of accounting entries and estimations, such as depreciation, provisions, or bad debt allowances, is a component of accrual-based earnings management. On the other hand, operational choices that affect cash flows—like modifying production schedules, postponing expenses, or increasing sales—are what constitute real earnings management. In order to fully represent the comprehensive character of management discretion, this study primarily takes into account both kinds. Earnings management is a range of practices that may be permitted under accounting rules but yet have an impact on how financial performance is interpreted; it does not always signify dishonest intent (Dechow & Skinner, 2000). As a result, this study acknowledges earnings management as a complex idea in which managerial choices, even when technically sound, have a big impact on stakeholder perception and company valuation.

Weak regulatory monitoring, unstable economic conditions, and managers' desire to convey business stability to creditors and investors may all contribute to the prevalence of earnings management in emerging nations like Nigeria (Alfraih, 2018). In order to have a more realistic picture of managerial behaviour, it is necessary to examine earnings management techniques in environments with less strict enforcement measures and market discipline. Earnings management has important ramifications for internal and external stakeholders. Because financial statements are used by creditors, investors, and regulators to make decisions, falsified earnings have the potential to deceive stakeholders and affect capital allocation and investment choices (Bushman & Landsman, 2019). Understanding the relationship between earnings management and audit mechanisms—specifically, how audit fees may either lessen or increase these managerial practices—is the main goal of this study.

Corporate governance frameworks are also intimately related to earnings management. While robust oversight might prevent opportunistic behaviour, firms with poor governance procedures may provide management more freedom to manipulate earnings (Klein, 2002). This study examines earnings management within the Nigerian industrial products industry, taking into account the function of board oversight, auditors, and other governance systems in preventing manipulative activities. Regardless of whether such acts are strictly compliant with accounting standards, this study uses a pragmatic definition of earnings management as

any management action that intentionally manipulates reported earnings to accomplish certain financial or strategic goals.

Audits Fees

The compensation given to external auditors for offering independent assurance on a company's financial statements is known as audit fees (Simunic, 1980). The entire amount of money or in-kind compensation given to auditors for performing audit services—including planning, carrying out, reporting, and any additional advisory services that may be agreed upon with the client—is referred to as audit fees in the context of this study. The size and complexity of the business, the extent of the audit engagement, and the perceived risk of auditing the customer are some of the elements that affect the calculation of audit fees (Carcello et al., 2011). Since they allow auditors to devote enough time and skill to thoroughly review financial records, higher fees are frequently linked to more thorough audits (Knechel et al., 2013).

Additionally, audit fees have a significant impact on the independence and conduct of auditors. Competitive rates can guarantee high-quality audits, but costs that are too expensive in comparison to the size of the client could undermine the independence of the auditor and lead to conflicts of interest (Chen et al., 2010). This study acknowledges that assessing audit fees' impact on audit quality and earnings management requires an understanding of both. According to Al-Hadi et al. (2020), audit costs in developing nations like Nigeria may also be a reflection of regional economic circumstances, legal mandates, and the unique difficulties involved in auditing industrial goods enterprises. These contextual considerations emphasise how crucial it is to evaluate audit fees' effects on the calibre of financial reporting by taking into account both their quantitative and qualitative components. In order to highlight their possible impact on audit quality, auditor independence, and ultimately the dependability of financial reporting, the study uses a pragmatic definition of audit fees as the entire amount paid by a business for audit services (Francis et al., 2005; Raghunandan & Rama, 2017).

Agency Theory

Agency Theory, which offers a framework for comprehending possible conflicts between business management and shareholders, serves as the foundation for this investigation. The idea basically says that when managers (agents) pursue personal interests that might not coincide with the aims of shareholders (principals), inconsistencies may arise (Jensen & Meckling, 1976). When it comes to earnings management, this discrepancy may cause managers to falsify financial statements in order to obtain advantages like job security or performance bonuses, which could be detrimental to the interests of shareholders. The necessity of monitoring and control systems to guarantee that managerial decisions are in line with shareholder goals is a fundamental component of agency theory (Fama & Jensen, 1983). One such tool is external audits, which offer supervision that prevents managers from acting opportunistically. Auditors help improve openness, lessen information asymmetry, and lower the danger of earnings manipulation by carefully reviewing financial accounts and adhering to accounting standards. The significance of audit fees in the auditing process is also clarified by the theory. By guaranteeing that managerial activities are thoroughly examined, adequate audit fees can support more extensive and resource-intensive audits, lowering agency-related risks (Carcello et al., 2011). However, there may be a risk to auditor independence if audit fees increase significantly in comparison to the firm's size or financial situation. This could inadvertently enable managers to manipulate results (Chen et al., 2010).

Additionally, according to agency theory, companies with inadequate corporate governance are more vulnerable to management opportunism. Managers may have greater latitude to falsify financial data in these situations, underscoring the importance of fee arrangements and audit quality in developing nations like Nigeria (Klein, 2002). This interaction emphasises how important it is to look into how audit fees affect managerial conduct in industrial goods companies in Nigeria. The theory also highlights how incentive structures influence managerial decision-making. Performance-based rewards have the potential to inspire managers to attain their goals, but they may also unintentionally encourage manipulating earnings (Healy, 1985). By comprehending these relationships, the study may investigate the ways in which governance practices and audit fees interact to influence managerial decisions and financial reporting integrity.

Prior Research

The complex relationship between audit fees and profits management has been the subject of an increasing amount of empirical study, which has shown both consistency and complexity in many circumstances. Alfraih (2018) looked at listed companies in emerging markets and found that lower earnings manipulation is frequently associated with higher audit fees, indicating that a larger financial investment in audits improves their quality. Al-Hadi, Abdullah, and Wahab (2020) also noted that firms that paid auditors more had lower levels of earnings management, highlighting the importance of audit fee size in encouraging efficient monitoring. On the other hand, excessively expensive audit fees may jeopardise auditor independence and enable earnings management to continue in intricate auditing contexts, as noted by Raghunandan and Rama (2017). Francis et al. (2015) went on to show that audit fees are strongly linked to accrual quality and transparency in mature market systems, highlighting their importance as a monitoring tool.

Research on consumer and industrial goods companies in Nigeria paints a contradictory image. According to Eze and Onuoha (2018), opportunistic reporting practices across Nigerian industrial enterprises decreased as audit quality improved with increasing audit fees. These results were confirmed in the banking industry by Chukwu and Alabi (2020), who found a negative correlation between audit fees and earnings management techniques. Nonetheless, Idowu and Oladipo (2019) observed cases in which high audit fees were associated with reduced auditor independence, which could unintentionally enable earnings manipulation in the context of inadequate corporate governance. The fundamental elements influencing the relationship between audit fees and earnings management have been studied by a number of academics. Akanbi (2015) highlighted that the impact of audit fees on earnings management can be mitigated by firm size, complexity, and regulatory enforcement. Shiyabade (2017) emphasised the challenges of inflation and macroeconomic instability in emerging economies, which could exacerbate incentives for manipulating earnings and undermine the impartiality of auditors. Similarly, Idris et al. (2018) emphasised the importance of corporate governance, showing that strong boards and efficient audit committees enhance the influence of audit fees on preserving the calibre of earnings.

Cross-sector and comparative assessments have been added to the scope of more recent studies. In their comparison of Nigeria's consumer goods and industrial sectors, Alonge and Afolalu (2021) found that audit fees had a greater impact on reducing earnings management in the industrial sector. In a study of service companies, Emeke (2021) found that increased audit fees enhanced financial statement dependability and decreased earnings manipulation. While Eze and Ukwueni (2023) discovered that audit fees could simultaneously function as

an incentive and a constraint for managerial discretion, contingent on the quality of governance and the terms of the audit engagement, Akinadewo et al. (2023) emphasised that audit fee sensitivity to firm risk enhanced monitoring in listed companies.

3. METHODOLOGY

Because the study was based on previously released financial data without variable modification, it used an ex-post facto research approach. All 12 industrial products companies that were listed on the Nigerian Exchange Group (NGX) as of 2023 made comprised the target population. A census approach was chosen because of the very small population, guaranteeing that all 12 enterprises were covered in the analysis. The financial statements and audited annual reports of these companies over the time period pertinent to the study's goals provided the data. In particular, data on firm size, audit fees, and accrual quality were extracted. Established accrual models were used to measure accrual quality, which stands for earnings management. The firm size was estimated using the natural logarithm of total assets, and audit fees were recorded as the audit expenses reported in the annual reports.

To summarise the features and distribution of the variables, descriptive statistics such as mean, minimum, maximum, and standard deviation were used to analyse the gathered data. The direct association between accrual quality and audit fees was evaluated, and the moderating effect of firm size was investigated, using correlation analysis. Additionally, the panel dataset was examined for serial correlation using the Lagrange Multiplier (LM) test, which helped determine which analytical model was best for the study.

Bivariate correlation (relationship test)

Pearson correlation between accrual quality and audit fees:

$$\sum_{i=1}^n (AQ_i - \overline{AQ})(AF_i - \overline{AF})$$

Hypotheses:

H0: $\rho_{AQ,AF}=0$ (no relationship)

H1: $\rho_{AQ,AF} \neq 0$ (significant relationship)

Moderation via partial correlation (controlling firm size)

Partial correlation of AQ and AF controlling FS:

$$r_{\{AQ,AF \cdot FS\}} = \frac{r_{\{AQ,AF\}} - (r_{\{AQ,FS\}} \times r_{\{AF,FS\}})}{\sqrt{1 - r_{\{AQ,FS\}}^2 - r_{\{AF,FS\}}^2 + r_{\{AQ,FS\}}^2 \times r_{\{AF,FS\}}^2}}$$

$$\sqrt{\{(1 - r_{\{AQ,FS\}}^2)(1 - r_{\{AF,FS\}}^2)\}}$$

Significance test

$$t =$$

$$r_{\{AQ,AF \cdot FS\}} \sqrt{\{n - k - 2\}}$$

$$\sqrt{\{1 - r_{\{AQ,AF \cdot FS\}}^2\}}$$

$$df = n - k - 2$$

where K =1 control variable (FS).

Hypotheses:

H0:ρAQ, AF·FS= (FS does not affect the AQ–AF relationship)

H1:ρAQ, AF·FS≠0 (FS significantly conditions the AQ–AF relationship)

4. RESULT, CONCLUSION, AND RECOMMENDATIONS

Descriptive Result

	AUDITFEE	ACCQUAL	LOGTA
Mean	62448.70	-0.048356	7.700214
Median	30311.00	-0.044214	7.513032
Maximum	200000.0	0.044412	9.195997
Minimum	18000.00	-0.213131	6.696520
Std. Dev.	60973.16	0.069443	0.884822
Skewness	1.315675	-0.576297	0.473679
Kurtosis	3.136303	2.757182	1.760586
Jarque-Bera	5.785489	1.156194	2.028030
Probability	0.055424	0.560965	0.362760
Sum	1248974.	-0.967123	154.0043
Sum Sq. Dev.	7.06E+10	0.091624	14.87530
Observations	60	60	60

The study's variables can be better understood thanks to the descriptive statistics. The median audit fee (AUDITFEE) for industrial products companies was 30,311.00, while the mean was 62,448.70. As evidenced by the maximum figure of 200,000, this suggests that while many organisations paid reasonable audit fees, others faced exceptionally expensive rates. The large variance in audit fees throughout the businesses is indicated by the standard deviation of 60,973.16. The distribution of audit fees is right-skewed, with high audit fees being less prevalent but raising the mean above the median, according to a positive skewness value of 1.32.

With a comparatively low standard deviation of 0.069 and an average of -0.048, accrual quality (ACCQUAL) indicated that most firms had slightly negative accruals, while there

were some extreme examples, as evidenced by the minimum value of -0.213. Its negative skewness (-0.576) indicates that some firms have a little tendency towards lower accrual quality. There were moderate variations in business sizes within the sample, as indicated by the mean of 7.70 and standard deviation of 0.88 for the natural log of total assets (LOGTA), which is employed as a measure of firm size.

Furthermore, an analysis of distributional features reveals that the kurtosis of ACCQUAL (2.76) and AUDITFEE (3.14) is near the typical benchmark of 3, indicating that extreme data are not statistically significant. A flatter distribution than the usual curve is indicated by LOGTA's kurtosis of 1.76, which suggests fewer extreme firm-size values. All variables' Jarque-Bera test findings showed p-values above 0.05, indicating that there is no discernible deviation from normalcy in the distributions.

Lagrange Multiplier Result

Lagrange Multiplier Tests for Random Effects

Null hypotheses: No effects

Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided
(all others) alternatives

	Cross-section	Test Hypothesis Time	Both
Breusch-Pagan	14.89828 (0.0001)	2.360670 (0.1244)	17.25895 (0.0000)
Honda	3.859830 (0.0001)	-1.536447 --	1.642879 (0.0502)
King-Wu	3.859830 (0.0001)	-1.536447 --	1.911916 (0.0279)
Standardized Honda	5.542527 (0.0000)	-1.414587 --	-0.224111 --
Standardized King-Wu	5.542527 (0.0000)	-1.414587 --	0.166151 (0.4340)
Gourieriou, et al.*	--	--	14.89828 (< 0.01)

*Mixed chi-square asymptotic critical values:

1%	7.289
5%	4.321
10%	2.952

The presence of random effects in the panel data used in this investigation was clarified by the Lagrange Multiplier (LM) test results. The null hypothesis that there were no random effects across the 12 industrial products firms was strongly refuted by the Breusch-Pagan statistic for cross-sectional effects, which was 14.89828 with a matching p-value of 0.0001. This suggests that there is unobserved heterogeneity among the businesses, which the model has to account for. On the other hand, time-specific random effects are not statistically significant, according to the LM test for time effects, which produced a statistic of 2.360670 with a p-value of 0.1244. However, firm-level variability dominates the panel structure and should be taken into account in subsequent regression calculation, as evidenced by the highly significant combination test for both cross-sectional and time effects (17.25895, $p = 0.0000$).

Alternative LM test variations, such the Honda, King-Wu, and standardised LM tests, offer further support for this claim. Each of these tests has consistently found substantial cross-sectional effects with p-values below conventional significance criteria. For example, the standardised test values were above the critical thresholds at the 1% level, however the Honda and King-Wu tests yielded identical statistics of 3.859830 ($p = 0.0001$). All things considered, these results provide credence to the use of a random effects model in this investigation because ignoring these firm-specific effects may lead to inaccurate or ineffective parameter estimations.

Correlation Analysis Result

Correlation Analysis

Date: 08/15/25 Time: 12:24

Sample: 2020 2024

Included observations: 60

Correlation t-Statistic Probability	AUDITFEE	ACCQUAL	LOGTA
AUDITFEE	1.000000 ----- -----		
ACCQUAL	-0.534017 -2.679733 0.0153	1.000000 ----- -----	
LOGTA	0.889709 8.268327 0.0000	-0.363931 -1.657705 0.1147	1.000000 ----- -----

For the sampled industrial goods firms, the correlation analysis reveals the kind and direction of the correlations between audit fees (AUDITFEE), accrual quality (ACCQUAL), and firm size (LOGTA). The results show that audit fees and accrual quality have a somewhat negative correlation (-0.534), which is statistically significant at the 5% level ($p = 0.0153$). This implies that auditors charge more when faced with more earnings management or less trustworthy accruals, and that companies with lower accrual quality are more likely to pay higher audit fees. The idea that lower accrual quality increases audit risk and, consequently, audit costs is supported by the negative association.

There is a significant positive correlation between audit fees and firm size as determined by the logarithm of total assets (LOGTA) (0.890, $p < 0.001$). This suggests that because of the complexity of their operations and the larger scope of audit work needed, larger firms tend to charge higher audit fees. Accrual quality and firm size had a negative (-0.364) but statistically insignificant ($p = 0.1147$) association, indicating that firm size has no discernible direct impact on earnings management in the sampled organisations.

Test of Hypotheses

H01: Accrual quality and audit fees of Nigerian industrial products enterprises are significantly correlated.

According to the correlation study, accrual quality and audit fees had a statistically significant negative connection of -0.534 ($t = -2.68$, $p = 0.0153$). The null hypothesis (Ho1) is rejected since the p-value is less than the 5% cutoff. This indicates that the audit fees of Nigerian industrial products companies are significantly impacted by accrual quality.

Ho2: The connection between accrual quality and audit fees of Nigerian industrial products companies is strongly moderated by firm size.

Partial correlation analysis was used to assess the moderating effect of company size while accounting for LOGTA. The findings supported the link between accrual quality and audit fees by demonstrating that firm size positively moderates the connection. The null hypothesis (Ho2) is rejected in light of these findings, suggesting that business size influences the relationship between accrual quality and audit fees, with larger firms typically paying higher costs even after taking accrual quality into account.

Conclusion

The study comes to the conclusion that audit fees in Nigerian industrial goods companies are highly impacted by earnings management, as measured by accrual quality. Due to increased audit risk, lower accrual quality is linked to greater audit expenses. Furthermore, it was discovered that business size had a major moderating effect because larger firms, which represent their operational complexity and scale, typically command greater audit costs regardless of accrual quality. These results highlight the significance of business size and the quality of financial reporting as key factors influencing audit pricing, highlighting the necessity of transparent reporting and strong internal controls for efficient audit cost management.

Recommendations

1. **Improve Financial Reporting Practices:** By minimising earnings management, businesses can increase the accuracy and dependability of financial reporting. Stakeholder confidence in financial disclosures can be increased and audit risk can be decreased by maintaining high-quality accruals.
2. **Include Firm Size in Audit Planning:** When creating audit protocols and calculating fees, management and auditors should take firm size into account. Larger companies inherently incur higher audit expenses because of their intricate operations. Adapting audit plans to the organization's size and breadth will guarantee equitable fee structures and effective resource allocation..

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