AUDIT QUALITY AND EARNING MANAGEMENT OF LISTED INSURANCE COMPANIES IN NIGERIA

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Abstract
This study examines audit quality and earnings management of listed Insurance companies in Nigeria over the period of 5 years (2015-2019). The study used simple random sampling technique to arrive at sample size of ten (10) insurance companies listed the floor of Nigerian Stock Exchange as at 2019. Secondary data extracted from annual reports and accounts of the sampled firms was analyzed using multiple regression. The regression result shows that audit firm size has a positive and significant impact on earnings management of the sampled firms, while joint audit service has a negative and significant impact on earnings management. However, auditor independence has negative and insignificant impact on earnings management. Therefore, the study recommends that regulators especially Security and Exchange Commission should encourage or make it as part of law to listed insurance companies in Nigeria to employs the service of both Big 4 audit firm and the local audit firm for audit assignment in order to safeguard firm's earnings from management manipulation.

Keywords: Audit Firm size, Independence, Joint Audit, Earnings Management, Insurance Companies.

1. Introduction

Earnings management is a widely researched area in the field of accounting for over two decades. Earnings management is generally regarded as a negative factor that affects the quality of financial report. In accounting literature, there are different terms that are identical with earnings management such as creative accounting, cooking the books, earnings manipulation, accounts manipulation, income smoothing to mention but a few. Apart from using accounting measures to manipulate earnings, managers also resort to real transactions. While showing that managers maneuver sales, overproduce inventory and reduce optional expenses to avoid incurring losses or missing analyst forecasts (Eriabie & Dabor 2017). Moreover, Bens, Hassan (2013), opined that firms also manipulate research and development costs to smooth reported earnings or avoid earnings per share dilution.

Audit Quality is among the factors that have an effect on the reliability of accounting information. This can be inspiration for more research on audit quality and the other factors that may influence it. Audit quality is defined as the possibility that an auditor would find out break in the owners accounting system and report the violated. The findings of misstatement measures quality in terms of the auditor's knowledge and ability, while the reporting of a misstatement is dependent on the auditor's incentives to disclose (Ozkan, 2018). Thus, the auditors should give a professional judgment concerning the creditability and reliability of accounting information enclosed in the annual reports and accounts for a particular period of time. However, the assessment carry out by auditors is vague ((Iwiyisi & Ifeanyi, 2018). Therefore, the audit process is not mostly assessable and the appraisal of the quality of audit services must be indirect indication. (Francis & Yu, 2009) have paying attention on either factor that influences audit quality or consequences of audit quality. This study considers the factors that will improve audit quality: auditor-specific attributes such as audit firm size, joint audit and auditor's independence.

Considerably several studies were conducted in different parts of the world to identify the impact of audit quality on earning management. Audit Quality proxies such as; Audit firm size, auditor's independence and joint audit service, However, many others were tested to measure earning management by using discretionary accruals. Some of these studies include but not limited to (Inaam, Khmoussi & Zehri 2012; Iwiyisi & Ifeanyi 2018; Jayeola, Taofeek & Toluwalase 2017; Ajekwe & Ibiamke 2017; Eriabie & Dabor 2017; Hassan & Faruk 2014). None of the previous studies focused on the listed insurance companies in Nigeria. This study therefore fills the identified gap in the previous studies.

The Financial industry in Nigeria has remained one of the pivots of the economy because of its vast capital base and lending capacity. Aside the federal government, the financial sector has the highest employer of labor and therefore needs transparent, reliable and efficient audit to control earnings manipulation, this encouraged for this research as many studies have done on banking sector without considering the exposure risk covered by the insurance companies. Therefore, aims at examine the impact of audit quality on earnings management of listed insurance firms in Nigeria.

2. Review of Related Studies

In this section, related literatures on audit quality and earnings management are reviewed and the theoretical framework for the study is presented.

Audit Firm Size and Earnings Management

There are inconclusive findings with respect to the relationships between audit quality and earnings management in the literature. For instance, with regard to audit firm size and experience Big 4 has been the common and a subject of audit quality studies (Ozkan (2018). Lobo, Paugam, Zhang and Casta (2016) documented that firms audited by Big 4-non-Big 4 auditor pair (BS) are more likely to book an impairment and book a larger impairment than firms audited by a Big 4-Big 4 auditor pair (BB) when low-performance indicators suggest a greater likelihood of impairment. Moreover, firms audited by a BB pair reduce impairment disclosures when they book impairments, while firms audited by a BS pair do not, suggesting lower transparency for firms audited by a BB pair.

Almarayeh, Aibar-Guzmán, and Abdullatif (2020) consolidated past studies in Jordan by a renewed investigation into the association between two auditor characteristics, namely auditor size and audit fees as well as earnings management. With a final 251 firm's/year observations, similar to past Jordanian studies, over a 5-year period, the results depict no significant influence of these two proxies of audit quality and restriction on earnings manipulations in Jordan. Further, the results based upon a generalized least square regression (GLS) show a positive and significant influence of all control variables (firm size, growth and ROA), except leverage, though positive but insignificantly related to accrual earnings management. In addition, a relatively low value (18%) was reported as the adjusted R2 indicative that the totality of the explanatory variable explains only 18 percent differences in earnings management. Similar study by Alzoubi (2016) examined the effect of disclosure quality on the magnitude of earnings management among 86 industrial companies quoted on the Amman Stock Exchange for four years between 2007 and 2010. Using a GLS regression in order to surmount the heteroskedasticity problems of OLS, the findings from the study show disclosure quality exerting a negative influence on incidence of earning management, accounting for 45 percent variations therein, thereby improve the quality of accounting information. Of note are size of the audit firm (measured by Big4 versus non-Big4 dichotomy), client's size (natural log of total assets) and clients' profitability (proxied with ROA). As expected, all displayed a negative and significant relationship with earnings management.

Ajekwe and Ibiamke (2017) examined the association between audit quality and earnings management of listed firms in Nigeria from 2009-2014. The study used OLS in analyzing the data. The study measures audit quality by audit firm size and earnings management by the absolute abnormal discretionary accruals using the modified Jones model. The study was carried out in two parts, the first part is the comparative study using independent sample t-test and the Wilcoxon signed ranked test. The second part is the multivariate analysis where the association between audit quality and earnings management was examined. Based on our analysis, we found that auditor size has restrained earnings management but the decrease is not statistically significant. This study adds to the literature on audit quality by showing that Big-Four auditors (proxy for audit quality) may not constrain earnings management of client firms in certain regulatory and institutional environments.

Auditor Independence and Earnings management

Martinez and Moraes (2016) investigated effect of audit fees on earnings management in Brazilian market using a sample of 300 firms listed on the BM&F Bovespa for which it was possible to identify the amount paid to the auditors, using data gathered from the Economatica database and the website of the Brazilian Securities Commission. The study analyzed the data using multiple regressions and the findings revealed a negative and significant relationship between audit fee and earnings management meaning that audit firms that charge less for their service tend to be more relaxed regarding earnings management by their client companies.

Similarly, Nawaish (2016) examined the prediction that external audit quality is positively associated with earnings management in Jordanian banking firms listed in Amman Stock Exchange (ASE). Findings revealed that audit tenure, audit fees, and auditor specialization have significant relations with earnings management. It means, future earnings management forecast is predictable based on audit quality leading indicators (audit tenure, audit fees, and auditor specialization).

Aliyu, Musa and Zachariah (2015) examined the impact of audit quality on earning management of listed deposit money banks in Nigeria for the period of 2006-2013. The study used the Ordinary Least Squares (OLS) regression technique of data analysis; the results show that audit quality has significant impact on the Earnings Management of listed deposit money banks in Nigeria during the period under the study. The results also show that audit firm size and joint audit services have significant negative impact on the Earnings Management of listed deposit money banks in Nigeria. While auditor financial dependence has a significant positive impact on Earnings Management of listed deposit money banks in Nigeria.

Joint Audit Service and Earnings Management

Empirical studies on joint audit also reported mixed results. Deangelo (1981) opined that recent literatures have encouraged joint auditors approach in ensuring objective financial reporting. That is the appointment of joint auditors to a firm will enhance its financial reports quality by minimizing earnings management.

A study by Francis et al. (2009) analyzed the consequences of France’s joint audit requirement on earnings quality and find that Big 4 auditor-pairs are associated with lower levels of income-increasing abnormal accruals. They found that in France firms with one or two Big 4 auditors are less likely to have income increasing abnormal accruals than other firms. Firms audited by two Big 4 auditors were even less likely to have income-increasing accruals. Big 4 auditors paired with non-Big 4 auditors are also associated with lower levels of income increasing abnormal accruals however to a lesser extent and concluded that a pecking order explains this with regards to earnings quality and auditor-pair choice.

Marmousez (2009) examined the impact of joint auditor pairs in France on financial reporting quality, measured by the degree of Earnings conservatism. He provides evidence that Big 4–Big 4 auditor pairs are not associated with earnings conservatism whereas Big 4–non-Big 4 auditor pairs are associated with conservatism. Jayeola *et. al* (2017) examined the relationship between audit quality and earning management in Nigeria deposit money banks. The study adopted a longitudinal research design and secondary data covering a period of 2005-2014 were collected. Panel data technique was employed, while fixed and random effects model were used for estimation. Descriptive Statistics, Pearson correlation coefficient and simple pooled OLS regression analysis were used for analysis to determine possible link between the variables identified. The results showed that joint audit has a significant positive relationship with earnings management, which implies that a change to joint audit from single audit increases earnings management. Moreover, results reveal that audit specialization has a significant negative relationship with earnings management, which implies that every unit increase in audit specialization decreases earnings management.

Mandour, File and Kwak (2018) examined the effect of joint audit and dual audits on earning management practices during the period 2010-2014. The purpose of the paper is to determine the impact of the voluntary adoption of the joint external audit approach in reducing earnings management practices through accruals and real operations compared with the adoption of the dual external audit approach. The study used multiple regressions to analyze the data. The research follows a quantitative approach to collect and analyze data from companies listed on the Egyptian stock exchange. The findings of the empirical studies show that there are consistent earnings management practices in the studied sample regardless of the type of audit (Joint or Dual audit). There is a negative association between joint audit and discretionary accruals compared to dual audit. This means that firms with joint audit are less engaged in accrual earnings management practices. In addition, large firms that adopt joint audit are less engaged in accrual earnings management. However, there is no effect of joint audit on real earnings management practices compared to dual audit. Our result is consistent for firm size, profitability, and leverage. Both firm profitability and leverage show positive association with earnings management practices while size did not have a significant effect on either type of practice. Finally, the study recommends that, firms with high (low) profitability that adopts joint audits are less (more) likely to engage in real earnings management practices.

3. Methodology and Model Specification

This study adopted a quantitative research approach where data was gathered through secondary approach. The population is made up of entirely twenty-eight listed insurance companies whose shares are traded in the Nigerian Stock Exchange (NSE). Simple Random samples were used to arrive at samples of 10 Insurance companies where Sunu Assurances Nigeria plc, Unic Insurance, Veritas Kapital Assurance Plc, Universal Insurance Company Plc and Regency Alliance Insurance Plc were eliminated as a result of unavailable data during the period of the study. Data were extracted from annual reports and account of 10 listed insurance companies in Nigeria for the period of 5 years 2015 to 2019. Statistical tools such as descriptive, correlation and regressions were employed to analyze the results of the study.

Table 1 Variables and their Measurement

Variables	**Proxies**	**Variables Measurement**	**Source**
Dependent	Discretionary Accruals	CFO-PAT/TA	Lisar, Lisar and Zadeh (2016)
Independent	Audit firm size	Dummy variable: 1= external auditor is 1 of the Big4, 0 otherwise.	Basiruddin (2011), Lisar, Lisar and Zadeh (2016)
	Auditors independent	Non-audit fees divided by total audit fees	Lin and Hwang (2010)
	Joint audit	Dummy variable 1= if the firm make use of joint audit 0 otherwise.	Hassan (2011)
Control Variables	Firm size	Natural log of total asset	Hassan and Bello, (2013) Hamid and Abubakar (2019)
	Firm Age	Years of listing	Hamid and Abubakar (2019) Das (2014)

Sources: Developed by the researcher, 2020

Model Specification

The multiple regression model for this study is specified as follows: -

$DA_{it} = \beta_0 + \beta_1 AFS_{it} + \beta_2 AI_{it} + \beta_3 JA_{it} + \beta_4 FSIZE_{it} + \beta_5 FAGE\ \mu$

Where:

DA = Discretionary Accruals

AFS = Audit firm size

AI = Auditors independence

JA = Joint audit

FSIZE = Firm size

FAGE = Firm age

β_0 = Fixed intercept/constant

β_{1-5} = Coefficient of the explanatory variables

μ = Error term

I = Insurance

t = Time

4. Results and Discussion

Descriptive Statistics

The descriptive statistics of variables under study were analyzed as contained in the table 2 below:

Table 2: Descriptive Statistics

Variable	Mean	Std. Dev	Min	Max
CFO	0.044	0.121	-0.218	0.646
AFS	0.640	0.484	0.000	1.000
AI	0.452	0.104	0.160	0.500
JA	0.440	0.501	0.000	1.000
FSIZE	23.65	0.918	22.00	25.60
FAGE	19.40	8.957	6.000	29.00

Source: STATA OUTPUT, 2020

Table 2 shows that the measure of earnings management (CFO) of listed insurance firms in Nigerian has a mean value of 0.044 with standard deviation of 0.121, and minimum and maximum values of -0.218and 0.646 respectively. This shows that the data move away from average value by 0.121. This suggests that the dispersion of the data from the mean is wide because the mean value is greater than the standard deviation. The Table 2 also indicates audit firm size (AFS) has an average value of 0.64 with standard deviation of 0.484, and the minimum and maximum values are 0.000 and 1.000 respectively. This shows that 48% of listed insurance companies in Nigeria were audited by large audit firm (Big 4) during the period of the study. The table 2 also shows that audit independence (AI) has a mean value of 0.452 with standard deviation of 0.104367, the minimum and maximum values of 0.16 and 0.5 respectively. Moreover, Table 2 shows that on average 44% of the samples firms utilized the services of joint audit (AJ) during the period under the study, from the mean value of 0.440 with standard deviation of 0. 501. The minimum and maximum values of joint audit as measured by dichotomous variables are 0 and 1 respectively. Finally, the results in Table 2 indicated that firm size and age has a mean value of 23.658 and 19.4 with standard deviation of 0.918759, and 8.957952 and minimum and maximum values of 22, 6 and 25.6 and 20 respectively.

Correlation Matrix

The correlation matrix is used to find out the degree of association between the dependent variable and Independent variables used in the study.

Table 3: Correlation Matrix

Variable	CFO	AFS	AI	JA	FSIZE	FAGE
CFO	1.000					
AFS	0.124	1.000				
AI	0.075	0.509	1.000			
JA	-0.076	-0.510	-0.008	1.000		
FSIZE	-0.163	0.217	0.202	-0.539	1.000	
FAGE	-0.148	0.033	0.412	0.4412	-0.098	1.000

Source: STATA OUTPUT, 2020

From the correlation results presented in table 3, the relationship between earnings management with the independent variables (i.e. audit firm size, auditor's independence, joint audit firm Size and Age) indicated that audit firm size and audit independence are positively but weak associated with earnings management, while joint audit, firm size and firm age are negatively and also association with earnings management in the listed insurance companies in Nigeria. From table 3 it can be observed that audit firm size (AFS) has appositive strong association with other explanatory variable with exception of joint audit. However, auditor independence has a weak and positive relationship firm size and firm age. From table 3 joint audits shows a negative but strong relationship with firm age while firm sizes have a negative but strong relationships with joint audit.

Regression Results

This constitutes the summary of the multiple regression results obtained from the model using ordinary least square regression. The results show individual impact between the independent variables (audit firm size, audit independence and joint audit) and finally the overall impact between the dependent variable and the independent variables. This is presented in table 4 below.

Table 4 : Summary of Regression Result

Variable	**Coefficient**	**T-value**	**P-value**
Constant	0.138	1.010	0.318
AFS	0.049	2.250	0.029
AI	-0.002	-1.100	0.279
JA	-0.031	-2.130	0.039
FSIZE	-0.002	-0.210	0.835
FAGE	-0.035	-0.660	0.514
F-Statistics			**2.96**
F-Sig			**0.022**
R square			**0.252**
Adjusted R Square			**0.167**

Source: STATA OUTPUT, 2020

From table 4 above, the results show an overall R square of (0.17), that is the coefficient of determination which represents the percentage of change in earnings management as explain by explanatory variables. This indicate that 17% changes in the earnings management is explain by explanatory variables used in the model; this signifies that the explanatory variables cumulatively bring about 17% changes in Nigerian listed insurance and 83% is explained by other factors not accounted for by the model. This implies that the model is fit and the variables are appropriately selected. In evaluating the model based on the regression results audit firm size as indicate in table 4.3 has a positive and significant impact on earnings management of listed insurance companies in Nigeria considering the coefficient value of0.049 and a p-value of 0.029 which significant at 5%. This suggests that as listed insurance companies continue use of big 4 audit firm lead to increase of earnings management by 5k.

Table 4 above also shows that joint audit services has a negative significant impact on earnings management of listed insurance companies in Nigeria from the coefficient of -0.031which is significance at 5% level of significance (P- value of 0.039). This suggests that as listed insurance companies continues to employs the joint audit services, the earning management decrease by 31k.

Similarly, the table shows that auditor independence has a negative and insignificant effect on earnings management of listed insurance companies in Nigeria. This signifies that auditor's independence does not have any impact of earnings management of listed insurance companies during the period under review.

5. Conclusion and Recommendations

This study has empirically provided evidence on the relationship between audit quality attributes proxies by audit firm size, auditor independence and joint audit on earnings management of listed Insurance firms in Nigeria. Based on the findings, it is concluded that audit firm size and joint audit service has significant impact on earning management of listed insurance company in Nigeria. However, study concludes that auditor's independence has negative insignificant impact on earning management of listed insurance companies during the period under review.

In line with findings and conclusions drawn from the study, therefore, the study recommends that the supervisory body especially Security and Exchange Commission have to encourage or make it as part of law to listed insurance firms in Nigeria to employs the service of both Big 4 audit firm and the local audit firm for audit assignment in order to safeguard firm's earnings from unwanted management manipulation.

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