# AUDITOR TENURE, AUDITOR INDEPENDENCE AND ACCRUAL – BASED EARNINGS MANAGEMENT OF QUOTED COMPANIES IN NIGERIA

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**ABSTRACT:** *Auditor Tenure defines the length of the auditor-client relationship while auditor independence (measured by the quantum of audit fees received) defines an auditor's quality of being free from influence, persuasion or bias, and hence the unbiased mental attitude in making decisions throughout the audit and financial reporting process. The absence of independence may greatly impair the value of the audit service and the audit report. On the other hand, an excessively long association between the auditor and his client may constitute a threat to independence. This study examines the relationship and effects of auditor tenure and auditor independence on the earnings management (measured by the amount of discretionary accruals) of companies in Nigeria. The study relies on secondary data derived from various companies' financial statements and the Nigerian Stock Exchange fact book to determine and measure the level of earnings manipulations in corporate financial statements, applying an all-inclusive multivariate analysis. The empirical analysis using a total of 342 company year observations, shows that Audit tenure and auditor independence exert significant effects and exhibit significant relationship with the amount of discretionary accruals of quoted companies in Nigeria. The descriptive statistics result reveals a minimal presence of discretionary accrual management by the companies in the sample and on the average; about 94% of the companies engage their audit firms for over three years, with a considerable experience of a substantial number of audit firms in this distribution.*

**KEYWORDS:** *Auditor Tenure, Auditor Independence, Auditors Reports, Discretionary Accrual, Earnings Management,*

## INTRODUCTION

The auditing and the audit process provide an evaluation of the probability of material misstatements and reduce the possibility of undetected misstatement to a reasonable or appropriate assurance level (Watts & Zimmerman, 1986; Knechel, 2009). Consequently, auditing has been acknowledged to influence financial reporting and provide robust impact on investors' confidence (Levitt, 1998). Essentially, external auditors typically perform significant and greatly challenging tasks in guaranteeing the credibility of financial reports (Mautz & Sharaf, 1961; Wallace, 1987). In view of the onerous challenges that face the audit function, some studies (Becker, Defond, Jiambalvo & Subramanyam, 1998; Bauwhede, Willekens & Gaeremynck, 2000; Heninger, 2001; Ebrahim, 2001; Piot & Janin, 2005; Gerayli, Yanesari & Ma'atoofi, 2011) have attempted to ascertain any noticeable relationship between auditor tenure, auditor independence and earnings management and have tried to

demonstrate the impact of this relationship on the quality of the earnings reported by quoted companies in many countries. The above studies show that the quality of audit is expected to minimize the extent of a firm's manipulations of reported income but majority of the results present a paradox of inconsistency and contradiction.

The demand for audit of companies' accounts is created by the agency problems which are related to the separation of corporate ownership from control (Eilifsen & Messier, 2000; Gerayli, Yanesari & Ma'atoofi, 2011). The agency problem arises from the existence of asymmetric information in the principal – agent contracts (Jenson & Messier, 2000). Some studies (Trueman & Titman, 1988; Dye, 1988; Schipper, 1989; Warfield, Wild & Wild, 1995) show that the existence of information asymmetry between corporate management and company shareholders greatly enhances the easy perpetration of earnings management practice. The audit of a company's accounts is a monitoring or control apparatus that minimizes information asymmetry and protects the interests of the principal.

Arrunada (2000) shows that the demand for auditing services arises from a need to facilitate dealings between the parties involved in business relationships – shareholders, creditors, public authorities, employees, customers, etc. Exchanges between such parties are usually costly since information asymmetries give rise to uncertainty concerning the performance of contractual obligations. The presence of information asymmetry makes it difficult for shareholders to detect earnings management. According to IAASB (2011), variations in stakeholder perspectives of audit quality suggest that no single element should be assumed as having the dominant influence on audit quality explained in this study by 'auditor tenure' and 'auditor independence'. This implies that a broader and deeper understanding of the complexities and nuances of the issue needs to be developed through studying the impacts of the two explanatory variables more holistically. In consonance with the Response Divergent Stakeholders' Theory (Freeman, 1999), it also implies that individual stakeholders should consider more carefully whether actions they endorse might have detrimental effects on others' perspectives of audit quality.

The auditors' theory of inspired confidence also offers a linkage between the users' requirement for credible financial reports and the capacity of the audit processes to meet those needs. Developed by the Limperg Institute in Netherlands in 1985, the theory of inspired confidence posits that the auditor, as a confidential agent, derives his broad function from the need for expert and independent assessment plus the need for an expert and independent judgement supported by evidence. Minimizing the risk of undetected material misstatements implies that the accountant is under a duty to conduct his work in a manner that does not betray the confidence which he commands before the rational person even if the accountant may not produce what is greater than the expectation of the public (Limperg Institue, 1985). The import of the theory of inspired confidence is that the duties of the auditors derive from the confidence that are bestowed by the public on the success of the audit process and the assurance which the opinion of the accountant conveys. Since this confidence determines the existence of the process, a betrayal of the confidence logically means a termination of the process or function. Carmichael (2004) discussed the social significance of the audit and asserted that when the confidence that society has in the effectiveness of the audit process and the audit report is misplaced, the value relevance of that audit is destroyed. Audit provides assurance to the owners, management, investors and

stakeholders of a company as well as provides confidence in financial reporting, corporate governance and the capital markets.

The value of a company's shares has been shown to represent the value of its future earnings (Lev, 1989) and this explains why investors in a company have vital interest in the earnings reports. This study defines earnings management as a strategy used by company managers to deliberately manipulate company earnings to match a predetermined target and involves the planning and execution of certain activities that manipulate or smooth income, achieve high earnings level and sway the company's stock price (Schipper, 1989; Healy & Wahlen, 1999). Earnings management is primarily achieved by managed actions that make it easier to achieve desired earnings levels through accounting choices in Generally Accepted Accounting Principles (GAAP) commonly described as Discretionary Accruals Management (DAM). Earnings management is also achieved by the manipulation of the operating activities of a company (Cash – Based or Real Earnings Management).

This study assumes that earnings management in an emerging market like the Nigerian Stock Exchange (NSE) is likely to present some problems for a true and qualitative earnings report. Anecdotal as well as empirical evidences on the effects of auditor tenure and auditor independence on earnings management of non-financial institutions may exist in the developed countries (DeAngelo, 1986; Defond & Jiambalvo, 1994, Beaseley, 1996, McMullen, 1996; Dechow, Sloan & Sweeney, 1995; Abbott, Parker & Peter, 2000; Becker *et al,* 1998, Bauwhede, Willekens & Gaeremynck, 2000). Such evidence on the relationship between auditor tenure, auditor independence and earnings management in emerging countries is scanty. In the case of Nigeria, it is not certain whether there is any existing study relating to the effects and association between auditor tenure, auditor independence and earnings management of quoted companies in the non – financial institutions as at the time of this study.

**Problem Analyses**

The recent corporate accounting scandals has cast doubt on the quality of reported earnings and the ability of audit process to effectively constrain earnings management of companies across the world and Nigeria in particular (Badawi, 2008; Enofe, 2010). Differences in quality of the audit process and auditors reports result in variations in the credibility of auditors and the reliability of the earnings reports of companies. These recent corporate financial failures pose a great challenge to the authenticity, integrity, effectiveness and significance of the audit function. Badawi (2008) reports a list of companies involved in cases of accounting scandals related to poor audit quality and earnings manipulations in the past decade. In Nigeria, corporate scandals include the cases of Cadbury Nigeria Plc and African Petroleum (AP) (Okolie & Agboma 2008); Savannah Bank and African International Bank (Odia, 2007); Wema Bank, Nampak, Finbank and Spring Bank (Adeyemi & Fagbemi, 2010); and more recently Intercontinental Bank Plc., Bank PHB; Oceanic Bank Plc. and AfriBank Plc.

The above are overtly reported cases that resulted in misleading financial reports. There is therefore a apprehension about the quality of accounting income and its relationship with the quality of the auditing process which has been observed to increase over time following the periodical clusters of business failures, frauds, and litigations. The issue is whether these corporate collapses are not the outcome of poor audit quality resulting from elongated auditor

tenure, lack of auditor independence and the inability of the audit function to arrest earnings management.

Accounting choices are made within the framework of GAAP. GAAP are the set of rules, practices, and conventions that describe what is an acceptable financial reporting for external stakeholders. The problem with many accounting choices is that there is no clear limit beyond which a choice is obviously illegal. Thus, a perfectly routine accounting decision such as expense estimation may be illegal if the estimated amount is extreme but perfectly legal if it is reasonable. Unfortunately, GAAP does not tell managers what specifically is normal and what is extreme and what is reasonable.

The reliance of external users on reported earnings as a fundamental variable for making decisions and recent corporate collapses mean that earnings management has become a matter of great apprehension. For instance, using numbers, management may abuse "big bath" restructuring charges, premature revenue recognition, reserves and write-offs of purchased in-process research and development (Healy & Wahlen, 1999). These practices can threaten the credibility of financial reporting. There are concerns regarding earnings management, which require factual and not fictional accounting to accentuate the importance of company accounts that are true and fair. The essence of this requirement is that companies must not distort, hide, fabricate and present, in whole or in part, deceitful financial reports.

Accrual – based earnings management is motivated by the need for accounting adjustments and allocations made at the end of a given year for a number of reasons. Usually, accounting for routine exchange transactions does not result in accounting records being properly stated on the accrual basis to make adjusting and allocation entries at the end of the accounting period. The required adjustments are necessitated by the need to ensure that the financial accounts disclose a true picture of the transactions and operations of the organization, as well as comply with GAAP. While the key concept is that GAAP – based accounting is supposed to reflect, and not obscure true economic performance, GAAP may also be violated by actions that result or do not result in fraud (Okolie, 2014).

GAAP rules are often arbitrary, complicated, and occasionally misleading. This is characterized as a means of selective financial misrepresentation. Management, shareholders, auditors, and standard setters are motivated to support GAAP because selective misrepresentation of economic reality benefits them in some ways (Revsine, 2002). The thought that only GAAP defines what earnings or income is, means that if management is following GAAP, earnings are not being misrepresented. It is however clear that GAAP permits many accounting choices and requires much estimation through accruals, deferrals and allocations, thereby facilitating earnings management; companies make innumerable operating and accounting choices and hence engage in some form of earnings management.

One position of this study is that the quality of the audit process as an outcome cannot be completely separated from financial reporting quality. Many accounting scandals of the past decade have involved outright manipulation of accounting data through discretionary accruals including recording fictitious inventory and hiding liabilities even in the face of audited financial reports. Knechel (2009) posits that the companies that have involved in real accounting scandals along with a number of lesser known companies greatly involved in transactions where the accounting was technically correct but which served primarily to obfuscate the financial wellbeing of the organizations and the results of their operations.

Wells (2005) reported that widespread manipulation of accounting information and income misstatements through discretionary accruals may be attributable to the pressure on corporate accountants, auditors and organizational managers to show profits. A common trend and threat among the companies that are involved in accounting and financial scandals are gross lack of integrity, character and transactions involving related parties (Geriesh, 2006, Enofe, 2010; Carey, 2006).

Given the above scenario, the major problem of this study is to determine whether auditor tenure and auditor independence can significantly constrain or minimize the negative consequences of earnings management of quoted companies in Nigeria. The study attempts to ascertain and establish whether there are significant relationships between auditor tenure, auditor independence and the amount of discretionary accruals of quoted companies in Nigeria.

## LITERATURE REVIEW

Extant literature relating to this study covers the areas of earnings management, Auditor Tenure, and the Auditor Independence as well as the perceived relationship which subsists between earnings management and each of the two perceived audit quality explanatory factors (Auditor Tenure and the Auditor Independence) and some exogenous variables related to earnings management.

### Earnings Management Concept

Corporate earning is the net income that represents a company's bottom line which has been recognized as a particularly most significant item in financial statements as they designate or signify the extent to which a company has engaged in value-added activities (Lev, 1989). Earnings signal the direction of resource allocation in capital markets as the theoretical value of a company's stock is the present value of its future earnings. Hence, increased earnings represent an increase in company value, while decreased earnings signal a decrease in the value of a company (Lev, 1989).

According to Schipper (1989), earnings management refers to a purposeful intervention in the external financial reporting process with the intent of obtaining some private gain. Healy and Wahlen (1999) assert that earnings management occurs when management uses judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about underlining economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers. Managing earnings is the process of taking deliberate steps, prompted by constraints of generally accepted accounting principles, to bring income to a desired level of reported earnings (Davidson, Stickney & Weil, 1987). Earning management may take the form of either income-increasing or income-decreasing accounting choices. Opportunities for such manipulation arise because of flexibility permitted by GAAP and because it is costly to require and enforce less flexible financial reporting rules (Dye, 1988, Evans & Sridhar, 1996).

Dechow and Skinner, (2000) classify earnings management into three categories, namely: Fraudulent Accounting, Accruals Management, and Cash Flow earnings management (CFEM) which is more often referred to as Real Earnings Management (REM). Fraudulent Accounting involves accounting choices that violate GAAP; Accruals Management involves choices within-GAAP that try to "obscure" or "mask" true economic performance. Real

earnings management occurs when managers undertake actions that involve changing a firm's underlying operations in an effort to boost current period earnings. Fraudulent accounting and accruals management are not accomplished by changing the underlying economic activities of the firm but through the choice of accounting methods used to represent those underlying activities. Dechow and Skinner (2000) further asserts that Accruals can be used to modify the timing of earnings recognition, thus causing earnings to either increase or decrease.

Two key attributes of accruals result in earnings management being the main mechanism by which earnings management is operationalised in the literature, namely; Non-discretionary and Discretionary accrual. Non-discretionary accounting adjustments are required by accounting standards and statutes, while discretionary accruals represent voluntary adjustments. FASB (1985) posits that accrual accounting uses accruals, deferrals, and allocation procedures to relate revenue, expenses, gains and losses to periods to respect an entity's performance during a period. Accounting choices are made within the framework of GAAP. GAAP are the set of rules, practices, and conventions that describe what is acceptable financial reporting for external stakeholders. The main sources of GAAP for quoted companies in Nigeria are:

1. the Statements of Accounting Standards (SAS) issued by Financial Reporting Councils of Nigeria (FRCN) including all the SASs FRCN inherited from Nigerian Accounting Standards Board (NASB);
2. IFRSs issued by IASB including all the IASs inherited from IASC up to 2001;
3. The companies and Allied Matters Act, 2004; and
4. Several other sources.

Many of the previous accounting studies (Healy, 1985; Jones, 1991; Sweeney, 1994; Defond & Jiambalvo, 1994)) examined the different motivations for earnings management and specifically point to bonus plans motivations, the motivations to satisfy the debt covenants, or the motivations to reduce the political costs. The earning management motivations may exist around the time of CEO change. According to DeAngelo, et al (1994), a new CEO may take a "*big bath*" in the year of change to increase the probability of higher future earnings against future performance measurement, especially when low earnings in the change year can be blamed on the previous CEO. Big Bath in accounting is an earnings management technique whereby a one-time charge is taken against income in order to reduce assets, which results in lower expenses in the future (Nikolai & Jefferson, 2010).

The desire to achieve a high stock price and/or to meet the earnings benchmark induces corporate managers to engage in earnings management. To meet a certain earnings target, managers can wait until the year-end to use discretionary accruals to manage reported earnings. But this strategy runs the risk that the amount of earnings that needs to be manipulated is greater than the available discretionary accruals because the discretion on accruals is bounded by GAAPs (Barton & Simko, 2002). Given the underlying economic transactions of a firm, manager's ability to report accrued earnings is limited. As a result, the earnings target may not be reached using discretionary accruals at year end (Graham, Harvey and Rajgopal, 2005). Managers can reduce this risk by manipulating fundamental real economic operating activities during the year (Cash – based Earnings Management). Graham et al. (2005) find evidence that managers take real economic actions to maintain accounting

appearances, and sometimes are more likely to use real actions than to use accruals to apply earnings management..

Specifically, if the compensation of managers is associated with companies' performance, then managers have incentives to misreport earnings. In consonance with agency problem (Jensen and Meckling, 1976) and because part of the financial reporting process depends on the judgment of managers, they have the opportunity to manage reported earnings to achieve their own goals. The capital market institutions (SEC, NSE, etc.) and other stakeholders may be more concerned with earnings management activities of firms' managers because these activities may have a significant effect on the quality of information provided to investors, (Scot, 1997; Healy & Wahlen, 1998).

A number of spectacularly large business failures, including Enron and Worldcom (in the US) Cadbury Nigeria PLC and African Petroleum AP (in Nigeria) involved earning management and accounting related scandals. These failures created negative publicity and loss of confidence in the capital market. Recent studies (Bradshaw & Sloan, 2002) have examined the issue of cash flow versus GAAP earnings and document an increasing rift between the two measures and show that investors typically react more to the cash flow numbers. Lougee and Marquardt (2002) provide support for opportunistic management through their examination of cash flow. Lougee and Marquardt (2002) found that a greater incidence of losses, higher market-to-book and debt-to-equity ratios, greater sales growth, a higher proportion of special items, and greater earnings variability characterize firms reporting cash flow earnings.

The fact that the market values a Naira of cash flow more than a Naira of current or non-current accruals implies that higher levels of accruals are indicative of lower quality of earnings. In other words, the degree to which a company must rely on accruals to boost net income results in lower quality of earnings. However, the first studies to investigate this issue (Sloan, 1996 and Swanson & Vickrey, 1997) found that, contrary to the efficient market hypothesis, disaggregating earnings into cash flow and accrual components is useful in identifying securities that are likely to outperform (or under-perform) in the future. Thus, the results of these studies imply that security prices do not fully reflect the information contained in the cash flow and accrual component of earnings.

The discretionary component of accounting earnings is assumed to be contained or located in accruals. Total Accruals (TAC) designates all the expenses and revenues accounted for in the Net Income (NI), but not intervening in the Cash Flow of given accounting period (Piot & Janin, 2005). Dechow, Sloan and Sweeney (1995) asserts that the analysis of earnings management often focuses on management's use of discretionary accruals.

In order to analyze the effects of audit tenure and auditor independence on Earnings Management, DAC was used in this study as proxy for estimating earnings management. The practice of using DAC to measure earnings management is consistent with prior studies (Cahan, Chavis & Elmendorf, 1997; Hall & Stammerjohan, 1997; Becker *et al,* 1998; Johnson & Rock, 2005). There may be alternative ways to estimate DAC. This study employs the modified – Jones (1991) model as used by Dechow *et al*, (1995). The modified – Jones model has been shown to perform better than other DAC models in detecting earnings management (Dechow *et al*, 1995) and has been greatly applied in some latter studies in

Accounting (Defond & Subramanyam, 1998; Guidry, Leone & Rock, 1999; Ebrahim, 2001; Gerayli, et al, 2011).

In this study, net income before tax (NIBT) is used instead of income before extra-ordinary or special items in order to avoid any abnormal accruals miscalculation by Jones (1991) model. This approach was adopted by Heninger, (2001) and Ebrahim (2001). The extra-ordinary and special items are usually not discretionary but Jones (1991) model misclassifies them as discretionary because they bear no linear relationship with changes in revenues. This study also applies CFO (as represented in the 'Cash Flow Statement') to estimate TAC and to eliminate any potential measurement errors that are inherent in using balance sheet items to indirectly compute TAC. It was argued by Hribar & Collins (2002) that some articulation events such as mergers and acquisitions may breakdown the presumed articulation between the balance sheet and the income statement. This may lead to the TAC estimated using the balance sheet items containing significant measurement errors compared to TAC computed directly using Cash Flow Statement. It was further argued that such measurement error will affect the ability of Jones (1991) model residuals to capture the managerial discretion as indicated by abnormal accruals.

**Concept of Auditor Tenure (AT)**
Financial reporting is essential for monitoring purposes. The external audit of company financial statements provides this monitoring and control. The principle of information disclosure is directed at ensuring the provision of relevant, reliable and sufficient information that enable stakeholders to take rational decisions. Investors, in particular require audited financial reports to make investments decisions and to assess the risk and returns expectations on their investments. Audit specifically provides shareholders and potential shareholders reasonable assurance that management's financial statements are free from material misstatements (Watts & Zimmerman, 1986). Investors therefore value the audit report as a means of improving financial information reported by companies.

In Nigeria, statutory audit of companies is enshrined in the 'Companies and Allied Matters Act, 2004, Section 357 which deals with the appointment by members at annual general meeting (AGM). Section 358 deals with the qualifications for the appointment of an auditor of a company and requires that a person shall not be qualified for appointment as an auditor of a company for the purpose of this Act, unless he is a member of a body of accountants in Nigeria established from time to time by an Act. The Statutory Duties of auditors are dealt with under section 359 CAMA 2004 and provides that: (i) The primary duty of the auditors of a company is to make a report to its members on the accounts examined by them, and on every balance sheet and profit and loss account, and on all group financial statements, copies of which are to be laid before the company in a general meeting during the auditors' tenure of office; (ii) Schedule 6 of CAMA 2004 sets out those matters that must be expressly stated in the auditors' report.

Auditor Tenure is defined in this study as the length of the auditor-client relationship. A rather too long association between the auditor and his client may constitute a threat to independence as personal ties and familiarity may develop between the parties, which may lead to less vigilance on the part of the auditor and even to an obliging attitude of the latter towards the top managers of the company. Aside from this threat to independence, the audit engagement may become routine over time, and if so, the auditor will devote less effort to identifying the weaknesses of internal control and risk sources. An experimental study by

Knapp (1991) tends to establish a connection between audit tenure and competence. As perceived by US audit committee members, the likelihood that the auditor will detect an anomaly increases in the first years of his mandate, and then decreases gradually, reaching its weakest level after 20 years of service. Hence, as a whole, a negative association is commonly assumed between auditor tenure and the quality of audit.

In reaction, and without mandating auditor rotation, stock market authorities generally impose a rotation of engagement partners. In the US, this rotation was reduced from seven to five years by the Sarbanes-Oxley Act, 2002. In May 2002, the European Commission recommended a rotation of engagement partners every seven years. Most member states have followed this recommendation, including the French market authority as from September 2002. However, the theory that auditor tenure is inversely related to audit quality is far from being corroborated by empirical research. Lys and Watts (1994) report that the likelihood of an auditor being subjected to legal action is not related to his tenure. Geiger and Raghunandan (2002) find that the likelihood that a going-concern audit report is issued prior to a bankruptcy filing is a positive function of auditor tenure. This suggests, to the contrary, that the quality of auditor reporting improves over time. Frankel, Johnson and Nelson (2002) observe a negative relationship between auditor tenure and abnormal accruals in absolute value, as well as a moderating effect of the former variable on income-decreasing earnings management.

Similarly, Myers, Myers. and Omer. (2003) find that auditor tenure reduces abnormal accruals whether positive or negative. Taken as a whole, these US studies run counter to the assumption that the quality of audit deteriorates as the length of auditor-client relationships increases. In France, auditors are chosen for six financial years. As a result, their mandate (and to some extent their tenure) enjoys a strong legal protection, initially enforced to limit opinion-shopping opportunities. However, this legal protection may have adverse effects. By reducing the role of market forces, it accelerates the formation of economic rents and the auditor's economic dependence on his client (Pigé, 2000). If this is so, the capacity of the auditor to resist managerial pressure is likely to deteriorate over time. In Nigeria, it is professionally required that audit tenure should not exceed three years but this does not appear to be enforced.

**Concept of Auditor Independence (AI)**
Audit Independence may be defined as an auditor's unbiased mental attitude in making decisions throughout the audit and financial reporting process. Independence refers to the quality of being free from influence, persuasion or bias, the absence of which will greatly impair the value of the audit service and the audit report (Sweeney, 1994). An auditor's lack of independence increases the possibility of being perceived as not being objective. This means that the auditor will not likely report a discovered breach (Deangelo, 1981). Prior studies assert that high fees paid by a company to its external auditor increase the economic bond between the auditor and the client and thus, the fees may impair the auditor's independence (Frankel et al, 2002; Li & Lin, 2005). The impaired independence results in poor audit quality and allows for greater earnings management and lower earnings quality (Okolie, 2013).

In Nigeria, a company audit committee performs an oversight and monitoring function on managers' discretion over accounting policies. McMullen (1996) identifies two levels at which a functional audit committee contributes to the quality of the audit process. Firstly, the

supervision of the financial reporting process and the examination of major accounting choices enable the Audit Committee to mitigate or constrain earnings management practices. Secondly, the coordination of both the internal audit and external audit, and particularly ensuring and assuring external auditors' independence from managerial influences or pressures enables audit committees to guarantee that irregularities and financial misstatement observed by external auditors are reported. Bedard, Chtourou and Courteau (2004) find that the possibility of aggressive earnings management decreases if the audit committee contains a financial expert or an expert in corporate governance and if it is composed wholly of independent directors.

Higher quality of audit process implies higher information credibility and information quality resulting in higher quality of financial statements and by extension credibility of auditors is subsumed in higher auditor quality. In accounting context, higher audit fees are reflected in higher costs resulting from greater audit quality. Some results have shown that larger audit firms receive larger audit fees than smaller audit firms (Palmrose, 1986; Copley, 1991; Wooten, 2003). Hence, Moizer (1997) asserts that audit fee is associated with higher audit quality resulting in higher reputation of the auditors. The essence of their arguments is that an individual has an economic incentive to incur above average costs in order to produce a service of above average quality. Eventually, consumers will recognize this improved quality and be prepared to pay a higher fee in order to receive the service. DeAngelo (1981) theorizes that larger firms perform better audits because they have a greater reputation at stake. In addition, because larger firms have more resources at their disposal, they can attract more highly skilled employees. Others have theorized that large auditors attract a fee premium because their greater wealth reduces clients' exposures in litigation (the deep pockets theory).

In Craswel, Stokes and Laughton (2002), it was shown that auditor independence may be related to audit fee dependence. Using the propensity of auditors to issue qualified audit reports measured by the ratio of audit fee to total national fee of the audit firm, Craswel *et al,* (2002) argued that in a situation where public disclosure of audit fee and non-audit fee is mandatory, auditors may be willing to issue qualified audit opinions irrespective of the economic importance of the client to the auditor and issue unqualified opinion if otherwise.

**Measurements of Auditor Tenure and Audit Independence**
The major proposition of this study is that Earnings Management depends on audit tenure and the degree of auditor independence of the auditor. In this study, we estimate audit quality by isolating each of the two relevant and commonly applied surrogates. Firstly, audit fees is applied to measure auditor independence (Palmrose, 1986, 1988; Moizer, 1997; Wooten, 2003; Craswel, et al, 2002); and secondly, auditor tenure (Knapp, 1991; Lys & Watts, 1994; Geiger & Raghunandan, 2002; Frankel *et al,* 2002; Myers *et al,* 2003; Pigé, 2000; Ebrahim, 2001); and we further consider and use together some selected different proxies in line with previous studies to control for the their exogenous effects on the dependent variable. We measure auditor independence using audit fees represented as natural log of the audit fees paid by the company while we measure auditor tenure as length of auditor-client relationship: '1' if 3 yrs[+] & '0' if otherwise.

We treat the individual variable effects as well as the effects of using the two audit quality attributes together in line with Heninger (2001), Ebrahim (2001), Piot and Janin, 2005, and Gerayli (2011). Using a number of explanatory variables after controlling for the effects of exogenous variables on the dependent variable is authenticated by Thierauf and Klekamp

(1975: 20) who posit that "a general model which will be representative of a system under study takes the form of $E = f (X_1, X_2, ... X_n, Y_1, Y_2, ... Y_n)$"; where: $E$ = objective function; $X_1$, $X_2 ... X_n$ = system variables that are subject to control (controllable variables); $Y_1, Y_2 ... Y_n$ = system variables that are not subject to control (uncontrollable variables).

**Evidence of Earnings Management practices in Nigeria**

In Nigeria, prior studies closely related to the present study include Okolie (2013), Akindayomi, 2012 and Osisioma and Enahoro (2006). Okolie, (2013) studied the effect and relationship between audit quality, earnings management and earnings response coefficients of quoted companies in Nigeria, and documented evidences that are consistent with the relationship and effects which audit quality exerts on earnings management from the perspectives of discretionary accruals manipulations and the manipulations of real economic operations of companies listed on the Nigerian Stock Exchange and extended the relationship between audit quality and earnings management to the relationship and effects which audit quality exerts on the earnings response coefficients as well as market prices per share of quoted companies in Nigeria. Based on a sample of 342 companies – year observations from the NSE for the fiscal years, 2006 to 2011, and using four of the commonly applied audit quality measures together, a massive and all-inclusive multivariate analysis was conducted. The result showed that audit quality is significant and negatively related to earnings management measured by discretionary accruals of quoted companies in Nigeria, exerts significant relationship with real earnings management and exerts significant influence on the earnings response coefficient and market price per share of quoted companies in Nigeria.

Akindayomi (2012) studied "Earnings Management and the Banking Crisis of the 1990s: Evidence from Nigeria". Akindayomi (2012) found that Nigeria banks show a positive association between earnings before taxes and provisions for loan losses, indicating earnings smoothing, and that healthy banks have smoother earnings than distressed ones while distressed banks deliberately understate loan loss provisions to inflate earnings.

Osisioma and Enahoro (2006) investigated whether financial accounting information users including Accountants, Company Managers, Investors, Investment Analyst, etc. in Nigeria are aware of earnings management in the Nigeria private sector. Using, structured questionnaire primary data, a survey analysis of a sample of 300 practicing accountants was conducted. The study reported that earnings management present a definite effect on information users. Thus, the practice of earnings management is constructively benefits the manipulator of accounts. This further indicates that the genuinely positive aspect of the corporation is presented to the fullest proportion to the public, while the area of weakness is played down in the reports in anticipation of correcting the weakness. The financial status is enhanced to enable the company to be attractive.

**METHODOLOGY**

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

$H_0$: There is no significant relationship between auditor tenure, auditor independence and the amount of discretionary accruals of quoted companies in Nigeria;

The major proposition of this study is that earnings management depends on auditor tenure and auditor independence. In this study, we estimate independent variables by isolating each of the two applied surrogates as follows: Audit Fees which is adopted as the measure for auditor independence and auditor tenure. We treat the effects of the two audit quality attributes together. The measurement and construct validity of the independent variables and the specific review of the various proxies of this study are contained in the Table 1 below.

**Estimation of Variables**

The dependent variable of the study is Discretionary Accrual used as proxy for earnings management while the independent variables include auditor tenure and auditor independence measured by the amount of audit fees received. The study examines whether each of these proxies is associated with earnings management. Discretionary accrual is measured using the Jones (1991) as modified by Dechow *et al* (1995) stated as:

$$TA_{i,t}/A_{it-1} = \alpha_i[1/A_{it-1}] + \beta_{1i}[\Delta REV_{it} - \Delta REC_{it}/A_{it}] + \beta_{2i}[PPE_{it}/A_{it-1}] + \varepsilon_{i,t} \quad \text{............................................................} (1)$$

This model estimates the discretionary portion of total accruals. To partition total accruals into its discretionary and non-discretionary components, Jones (1991) used the following expectation model for total accruals to control for changes in the firm's economic circumstances:

$$TA_{i,t}/A_{it-1} = \alpha_i[1/A_{it-1}] + \beta_{1i}[\Delta REV_{it}/A_{it-1}] + \beta_{2i}[PPE_{it}/A_{it-1}] + \varepsilon_{i,t} \quad \text{.........................................................................} (2)$$

Where, for (1) and (2):
$TA_{i,t}$ = Total accruals in year t for firm I;
$A_{it-1}$ = Total assets in year t − 1 for firm i;
$\Delta REV_{it}$ = Change in Revenues in year t less revenues in year t − for firm I;
$\Delta REC_{it}$ = Change in accounts receivables in year t less receivables in year t − for firm I;
$PPE_{it}$ = Gross property, plant and equipment in year t for firm i;
$\varepsilon_{i,t}$ = Error term in year t for firm i.

Jones (1991) used ordinary least squares regression for equation (2) to generate firm specific coefficients for $\alpha_i$, $\beta_{1i}$ and $\beta_{2i}$. These coefficients were then used to estimate the level of non-discretionary accruals for each sample firm as specified in the above equations. The level of discretionary accruals was then estimated by Jones (1991) using the following model to estimate the extent of earnings management:

$$DA_{it} = TA_{i,t}/A_{it-1} - NDA_{it} \quad \text{...........................................................................................................} (3)$$

Where:    $DA_{it}$ = Discretionary accruals in year t for firm i
     $TA_{i,t}$ = Total accruals in yeat t for firm I;
$A_{it-1}$ = Total assets in year t − 1 for firm I;

$NDA_{it}$ = Non-discretionary accruals in year t for firm I $(TAit - DA_{it})$

## 3.2 Model Specifications

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

$$DAC_{i,t} = a_0 + \beta_1 AF_{i,t} + + \beta_2 AT_{i,t} \ \beta_3 CFO_{i,t} + \beta_4 Gwth_{i,t} + \beta_5 CoySize_{i,t} + \beta_6 Lev_{i,t} + e_{i,t}$$
………….……………. (4)

The above equation is used to treat for robustness in order to correct for the effects of the constraints of using single audit proxies by applying the two identified perceived audit quality attributes together Henninger, (2001), Ebrahim (2001), Piot and Janin (2005), Gerayli et al (2011). In terms of data analyses techniques, this study used pool and panel data with the application of Least Square (LS) regression analyses. The dependent variables and independent variables were pooled across section and time. Eviews, version 7.0 econometric package was applied to the pooled and panel data from 2006 to 2011 to estimate the model and model coefficients.

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

## TABLE 1: Measurement of Variables

| S/N | VARIABLES | DEFINITION | TYPE | MEASUREMENT |
|---|---|---|---|---|
| 1 | DAC | Discretionary Accruals Management | Dependent | Total Accrual minus Non-Discretionary Accrual |
| 2 | AF | A measure of Auditor Independence | Independent | Natural Log of the Audit Fees Paid by the company. |
| 3 | AT | Audit Tenure | ,, | Length of auditor-client relationship: '1' if 3 yrs[+] & '0' if otherwise. |
| 4 | CFO | Cash Flow From Operations | Control | CFO as % of Total Assets at end of Year't'. |
| 5 | Gwth | Growth Prospects of the Company | ,, | (Market Value divided by Book Value of Equity) = MPS/BVPS |
| 6 | CoySize | Company Size | ,, | Natural log of company Total Assets |
| 7 | Lev. | Leverage | ,, | Total Debts /Equity |

**Descriptive Statistics**

Table 4.1 below presents the result for the descriptive statistics conducted on the variables. The result showed that DAC has a mean value of -1.00E-17 which suggest very minimal DAC value for the sample. The maximum, minimum and median values stood at 3.069; -0.018 and -1.581 respectively while the standard deviation is 0.279. The Jacque-Bera statistic of 31907.2 alongside its p-value (p=0.00<0.05) indicates that the data satisfies normality and the unlikelihood of outliers in the series.

**Table 4.1: Descriptive Statistics**

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

Source: computation derived from Eviews 7.0 by the author

Where: DAC = Discretionary Accruals, AF = Audit Fees, AT = Audit Tenure, CFO = Cash Flow From Operations, Gwth = Company Growth Prospects, CoSize = Company Size, Lev = Leverage

**AF** was observed to have a mean value of 6.8217 and a standard deviation of 0.5778 suggesting considerable clustering of audit fees for the distribution around the mean value. The maximum, minimum and median values are 8.223, 5.04 and 6.9 respectively. The Jacque-Bera statistic of 16.927 alongside its p-value (p=0.00<0.05) indicates that the data satisfies normality.

**AT** was observed to have a mean value of 0.942 which suggest that almost all (94%) the firms in the sample have had engagement with their audit firm for over 3 years. The standard deviation of 0.233 further indicates that there is the existence of a considerable number of firms in the distribution. The Jacque-Bera statistic of 3459.362 alongside its p-value (0.00) indicates that the data satisfies normality.

**CFO** was observed to have a mean value of 11.664 and standard deviation of 16.673. The maximum, minimum and median values stood at 99.49, -126.16 and 11.7 respectively. The Jacque-Bera statistic of 3494.981 alongside its p-value (p=0.00<0.05) indicates that the data satisfies normality.

**GRWTH** measured as the Market Value divided by Book Value of Equity has a mean of 8.668 and standard deviation of 72.647. The maximum, minimum and median values are 122.833, -24.64 and 2.7 respectively. The Jacque-Bera statistic of 922498 alongside its p-value (p=0.00<0.05) indicates that the data satisfies normality.

**COSIZE** measured as the natural log of company total assets was observed to have a mean value of 9.8797 and standard deviation of 0.790. The maximum, minimum and median values stood at 11.66, 7.87 and 9.97 respectively. The Jacque-Bera statistic of 10.888 alongside its p-value (p=0.00<0.05) indicates that the data satisfies normality.

**LEV** shows a mean value of 5.505 and standard deviation of 43.157. The maximum, minimum and median values stood at 685.82, -15.7 and 1.39 respectively. The Jacque-Bera statistic of 696687 alongside its p-value (p=0.00<0.05) indicates that the data satisfies normality.

**Regression Assumptions Tests**
Table 4.1 has revealed that the p-values associated with Jarque-Bera statistics for the variables are all less than 0.05 indicating the normality of data and suitability for generalization. It also suggests the absence of outliers in the data. Table 4.2a to table 4.2d below present the regression assumptions tests.

**Table 4.2a: Regression Assumptions Test (Dependent Variable = DAC)**

| Variance inflation test for Multicollinearity | | | |
|---|---|---|---|
| Variable | Coefficient Variance | Centered VIF | |
| C | 0.057367 | NA | |
| AF | 0.003418 | 5.336608 | |
| AT | 0.005258 | 1.140082 | |
| CFO | 7.93E-07 | 1.071542 | |
| GWTH | 9.18E-08 | 2.856693 | |
| COSIZE | 0.002956 | 9.567647 | |
| LEV | 1.83E-07 | 2.76272 | |

| Breusch-Godfrey Serial Correlation LM Test: | | | |
|---|---|---|---|
| F-statistic | 0.125097 | Prob. F(1,182) | 0.724 |
| Obs*R-squared | 0.133254 | Prob. Chi-Square(1) | 0.7151 |

| Heteroskedasticity Test: Breusch-Pagan-Godfrey | | | |
|---|---|---|---|
| F-statistic | 1.33545 | Prob. F(9,184) | 0.2212 |
| Obs*R-squared | 11.89525 | Prob. Chi-Square(9) | 0.2193 |
| Scaled explained SS | 96.39948 | Prob. Chi-Square(9) | 0.3219 |

| **Ramsey RESET Test** | | |
|---|---|---|
| **Specification: DAC, C, AF, AT, CFO, GWTH, COSIZE, LEV** | | |
| | Value | Probability |
| t-statistic | 0.862159 | 0.3895 |
| F-statistic | 0.743318 | 0.3895 |
| Likelihood ratio | 0.777317 | 0.378 |

Source: Computation derived from Eview 7.0 by the author

Table 4.2a above shows the regression assumptions test for the models. In relation to DAC, none of the variables has VIF's values exceeding 10 and hence none give serious indication of multicollinearity. The Breusch-pagan-Godfrey test for heteroscedasticity was performed on the residuals as a precaution. The results showed probabilities in excess of 0.05, which leads us to reject the presence of heteroscedasticity in the residuals. The Lagrange Multiplier (LM) test for higher order autocorrelation reveals that the hypotheses of zero autocorrelation in the residuals were not rejected. This was because the probabilities (Prob. F, Prob. Chi-Square) were greater than 0.05. The LM test did not therefore reveal serial correlation problems for the model. The performance of the Ramsey RESET test showed high probability values that were greater than 0.05, meaning that there was no significant evidence of misspecification.

**Panel Unit Root Test**

In conducting the panel unit root, the Augmented Dicky Fuller test is utilized. For robustness, we also conduct the unit root using the Breitung t-stat and the Im, Pesaran and Shin W-stat . All tests are conducted at intercept and trend and the results are presented and analyzed below;

**Table 4.3a Augmented Dickey Fuller (ADF) Unit Root Test**

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

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

**Table 4.3b Breitung Unit Root Test**

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

Source: Computation derived from Eview 7.0 by the author

**Table 4.3c Im, Pesaran and Shin unit root test**

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

Source: Computation Derived from Eviews 7.0

Table 4.3a, b & c above provide summary reports of panel unit root tests on the residuals of the regressions reported in

The p-values reported in Table 4.3a suggest that the hypothesis of no unit root can be rejected at least at the 5% level. Also, the ADF Fisher statistic (570.45) and the Choi Z-stat. (-17.214) for the stacked residuals indicate that the null hypothesis of non-stationary is strongly rejected.

In addition, the Breitung Unit Root Test is also performed and the results shows that the Breitung t-stat (-7.2286) and p-value (0.00) as presented in table 4.3b suggest that the null hypothesis of non-stationarity is strongly rejected at 5%. The Im, Pesaran and Shin unit root test was also performed as an additional check to confirm the stationarity of the data. The results shows that the Im, Pesaran and Shin W-stat (-109.105) and p-value (0.000) as presented in table 4.3c suggest that the null hypothesis of non-stationarity is strongly rejected at 5%.

**Regression Tests**
The regression tests were conducted to examine the sensitivity of the endogenous variable on the baseline equation that include both audit tenure and audit fees (which was used as the proxies for auditor independence). Firstly, we begin by testing if the coefficients of the variables are sensitive to the inclusion of both explanatory variables together in the model.

**Table 4.4 Regression test for Model (Dependent Variable = DAC)**

| | POOLED OLS | OLS | | PANEL OLS | PANEL |
| --- | --- | --- | --- | --- | --- |
| | | | | | (FIXED EFFECTS) |
| | | (RANDOM EFFECTS) | | | |
| VARIABLE | COEFFICIENT | PROB. COEFFICIENT | PROB | COEFFICIENT | PROB. |
| C | -0.023 | 0.968 1.176 | 0.013 0.000* | 0.965 | - |
| *EXPLANATORY* | *VARIABLES* | | | | |
| ACI | -0.001 | 0.761 0.014 | -0.001 0.000* | 0.815 | - |
| AF | -0.007 | 0.948 0.082 | -0.003 0.001* | 0.957 | - |
| AFS | 0.045 | 0.487 | 0.028 | 0.533 | - |

| | | 0.152 | 0.000* | | | |
|---|---|---|---|---|---|---|
| AT | -0.037 | 0.235 | | -0.034 | 0.645 | - |
| | | 0.007 | 0.613 | | | |
| *CONTROL* | *VARIABLES* | | | | | |
| CFO | 0.001 | 0.596 | | 0.001 | 0.216 | - |
| | | 0.001 | 0.142 | | | |
| GWTH | 0.002 | 0.002* | | | 0.002 | 0.021* |
| | | 0.004 | 0.002* | | | |
| LEV | -0.025 | 0.001* | | -0.058 | 0.463 | - |
| | | 0.002 | 0.006* | | | |
| $R^2$ | 0.184 | | | 0.184 | | |
| | | 0.864 | | | | |
| ADJ $R^2$ | 0.134 | | | 0.146 | | |
| | | 0.823 | | | | |
| F-Stat | 7.202 | | | 4.853 | | |
| | | 21.279 | | | | |
| P(f-stat) | 0.000 | | | 0.000 | | |
| D.W | 2.083 | 0.000 | | | | |
| *Hausman test* | **0.54** | | | 2.09 | | |
| | | 2.125 | | | | |

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

## Pooled (Stacked) OLS Regression Test Result

The pooled (stacked) OLS result has an $R^2$ value of 0.184 which suggest an 18.4% explanatory ability of the model for the systematic variations in the dependent variable with an adjusted value of 0.134. The F-stat (7.202) and p-value (0.00) indicates that the hypothesis of no significant relationship between the dependent and independent variables cannot be accepted at 5% level. An evaluation of the effects of the explanatory variables on the amount of DAC, we examine their slope coefficients.

AF appeared negative (-0.007) and insignificant at 5% (p=0.948). AFS appeared positive (0.045) and insignificant at 5% (p=0.487).

AT also appeared negative (-0.037) and insignificant at 5% (p=0.235). CFO appeared positive (0.001) and insignificant at 5% (p=0.596). Gwth appeared positive (0.002) and statistically significant at 5% (p=0.002). The effect of leverage also appeared negative (-0.025) and statistically significant at 5% (p=0.001). The D. W. statistics of 2.083 indicates the absence of serial correlation of the residuals in the model.

## Panel OLS (Fixed Effects) Regression Test Result

The Panel OLS (Fixed effects) estimation shows an $R^2$ value of 0.184 which suggests an 18.4% explanatory ability of the model for the systematic variations in the dependent variable with an adjusted value of 0.146. The F-stat (4.853) and p-value (0.00) indicates that the hypothesis of no significant linear relationship between the dependent and independent variables cannot be accepted at 5% level. An evaluation of the effects of the explanatory variables on the amount of DAC shows the slope coefficients in which AF appeared negative (-0.003) and insignificant at 5% (p=0.957). AT appeared negative (-0.034) and insignificant

at 5% (p=0.645). CFO appeared positive (0.001) and insignificant at 5% (p=0.216). Gwth appeared positive (0.002) and statistically significant at 5% (p=0.021). The effect of leverage appeared negative (-0.058) and statistically insignificant at 5% (p=0.463). The D. W. statistics of 2.09 indicates the absence of serial correlation of the residuals in the model.

**Panel OLS (Random effect) Regression Test Result**

Based on Hausman test result, the Random effects panel data analysis was conducted and the result indicates a significantly higher proportion of systematic variations in the dependent variable. This suggests that the causal-relationship between auditor tenure, auditor independence and DAC in the sample is influenced by cross-section specific effects which are realizations of independent random variables with mean zero finite variance and uncorrelated with the idiosyncratic residual. The $R^2$ value was considerable (0.864) and explains about 86.4% of the systematic variations in the dependent variable with an adjusted value of 0.823. The F-stat (21.279) and p-value (0.00) indicates that at 5% level, the null hypothesis is dropped for the alternative hypothesis of a significant linear relationship between the dependent and independent variables.

On evaluation of the effects of the explanatory variables (AQ measures) on the amount of DAC, their slope coefficients were examined. AF appeared negative (-0.082) and significant at 5% (p=0.001); AT appeared negative (-0.034) but insignificant at 5% (p=0.613). CFO appeared negative (0.001) but insignificant at 5% (p=0.146). Gwth appeared positive (0.004) and statistically significant at 5% (p=0.002); leverage appeared negative (-0.002) and statistically significant at 10% (p=0.006). The D. W. statistics of 2.13 indicates the absence of serial correlation of the residuals in the model.

**DISCUSSION OF THE RESULTS AND FINDINGS**

In estimating the models, we employed the pooled OLS and Panel effects estimations. Our preference for the variable estimates used in discussing the results is based on the descriptive statistic and Hausman Test.

The mean value of Discretionary Accrual (-1.00E-17) suggests a very minimal presence of DAC manipulation by the sampled companies. This corroborates the evidence in the USA by Graham et al (2005) and Cohen, Dey and Lys, (2008) that accrual-based earnings management is more likely to draw audit and regulatory scrutiny than cash – based decisions. Hence corporate managers have shifted away from Discretionary Accrual Management to Cash - Based Earnings Management in the post Sarbanes – Oxley Act (SOX) period. This situation appears to be ostensibly replicated in Nigeria, perhaps because of the effects of globalization of World accounting and economic policies, and an anticipation of the adoption of SOX, IFRSs and similar codes of best practices which apparent partial presence is indicated by the promulgation of Financial Reporting Council of Nigeria Act, 2011.

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

Using the Panel OLS (fixed effects) estimation result in line with the Hausman test, we find that, when we estimate the model using single measure for audit quality, the effect of Audit fees on the level of discretionary accruals is positive and significant at 5% level. This empirically validates the argument that higher fees may result in impairment of auditor independence (Sweeney, 1994) and hence create greater opportunities for accrual manipulation (Palmrose, 1986, 1988; Moizer, 1997; Wooten, 2003; Craswel, et al, 2002). Some previous studies have shown that larger audit firms receive larger audit fees than smaller audit firms (Palmrose, 1986; Copley, 1991; Wooten, 2003). These prior results were agreed to by Moiser (1997) who asserts that Audit Fees is significantly associated with auditor independence. However, there appears to be a conflict between this result and some other previous research especially when AF is treated as a measure of Auditor Independence (AI). Sweeney (1994), show that in the absence of independence, the value of the audit service is greatly impaired. An auditor's lack of independence increases the possibility of being perceived as not being objective and qualitative. This implies that such auditor may not likely report a discovered breach. Sweeney (1994) contends further that higher fees paid by a company to its external auditors increase the economic bond between the external auditor and the client. Thus, the fees may impair the auditor's independence (Frankel et al, 2002; Li & Lin, 2005). In this respect, the result of this study is therefore expected as the impaired independence leads to poor AQ, allowing for higher Earnings management and poor earnings quality.

The effect of auditor tenure on the level of discretionary accruals is negative (-0.021) and significant (p=0.007) at 5% level and suggest that longer auditor tenure may also result in less opportunities for accrual management (Frankel *et al,* 2002; Myers *et al,* 2003). The auditor expertise hypothesis supports this argument indicating that the auditor learning curve associated with longer tenure may be effective in checking opportunistic behaviours of management. The findings provide evidence that auditor tenure and auditor independence impact significantly on the level of discretionary accruals of a company. Hence, the null hypothesis of a no significant relationship between auditor tenure, and auditor independence and Discretionary Accruals is rejected. The alternative hypothesis of significant negative relationship between independent variables and the amount of Discretionary Accruals of Quoted companies in Nigeria is upheld at 5% level of significance. This result seems to move along the direction of Auditor expertise hypothesis. In line with this hypothesis, some prior studies have shown that larger Audit Firms receive larger audit fees than smaller audit firms (Palmrose, 1986; Copley, 1991; Wooten, 2003), and on the basis of this, AF is significantly, related to audit quality (Moiser, 1997).

## SUMMARY OF FINDINGS

The summary of findings of this study is based on results of both the descriptive statistics and the various tests conducted on the OLS multiple regression models. These findings have been discussed elaborately above. The summary of findings is as follows:

1. The Audit tenure and auditor independence exert significant effects and exhibit significant negative relationship with the amount of Discretionary Accruals of quoted companies in Nigeria;

2. The result of descriptive statistics reveals a very minimal presence of Discretionary Accrual management by the companies in the sample; and

3.  The descriptive statistic test result reveals that on the average, companies (about 94%) engage their audit firms for over three (3) years, with a considerable experience of a substantial number of audit firms in this distribution.

4.  The tests results also suggest a considerable cluster of audit fees (used to measure auditor independence) for the distribution around the mean value. The effect of Audit fees on the level of discretionary accruals was positive and significant. This empirically validates the argument that higher fees may result in impairment of auditor independence and hence create greater opportunities for accrual manipulation.

## POLICY IMPLICATIONS OF FINDINGS

The policy implications of our findings are as follows:

1.  The minimal presence of DAC may suggest a rather very large presence of cash – based earnings manipulation among all the companies in the sample, which may further imply that managers are induced to shift from accrual – based to cash - based earnings manipulation activities in order to avoid legally required detection of earnings management through Discretionary accruals manipulations. Accrual-based earnings management by implication, is more likely to draw audit and regulatory scrutiny than real earnings management during the post US SOX period (Graham et al, 2005; Cohen et al, 2008), consequent upon the highly publicized accounting scandals (Badawi, 2005, 2008; Enofe, 2010), a situation which this study shows to be replicated in Nigeria.

2.  The reported results and findings of this study present obvious implication for regulators such as the Securities and Exchange Commission in its supervisory position to distinguish between legitimacy, outright fraudulent reporting and earnings statements that reflect the desires of management rather than the underlying performance of the company and to impose appropriate disciplinary penalties on offenders.

3.  The result of this study has shown that if company's earnings are not properly monitored, companies will continue to deviate from reporting correct earnings figures by presenting earnings figures that appear beautiful but are not true; hence investors and other stake holders are deceived.

4.  The Auditors standing expertise notwithstanding, an overly long association between the auditor and his client may constitute a threat to independence and hence audit quality as personal ties and familiarity may develop between the parties. This will lead to less vigilance and an obliging attitude of the auditor towards the top managers of the company. Apart from the threat to independence, the audit engagement may become routine over time resulting in devotion of less effort to identifying the weaknesses of internal control and risk sources.

## RECOMMENDATIONS

This study recommends that:

1.  The management of quoted companies in Nigeria should, as a legal mandate, provide a "statement of the quality of its earnings" arrived at using acceptable and uniform criteria and make assertions that the earnings of the company have not been manipulated (managed) during the period. Management can be held liable for any misstatement intended to distort or mislead the public with respect to the "quality of earnings".

2.  The auditors of quoted companies in Nigeria should conduct Earnings Quality Assessment (EQA) following acceptable Earnings Management detection metrics and the techniques and issue "Integrated Audit Reports" which will include EQA reports and Internal Control Reports in addition to normal annual audit reports. EQA reports will provide higher – quality

information to financial statement users and meet the Stock Exchange, Regulatory Agencies and the public demand for greater assurance about the reliability of earnings figures. The conduct and completion of the EQA should be a legislative mandate while the auditors should be held responsible for EQA report they issue.

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

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

## CONTRIBUTIONS TO KNOWLEDGE

In Nigeria in particular and to the best of our knowledge, only scanty evidences relating to the association of audit tenure and auditor independence with discretionary accruals management exists. Therefore, this study contributes to knowledge in several ways as shown below:

1. The study provides significant basis to meet the need for the development of uniform and consistent model for measuring earnings quality by relating auditor tenure and auditor independence to discretionary accruals of Quoted companies in Nigeria. This is the metric that can recognize many of the fragilities of GAAP, and take into account factors that are expected to affect future earnings but that are not explicitly disclosed in the financial statements.

2. This study adds to existing Knowledge on Earnings Management by showing that when the quality of audit is high, corporate managers will shift away from managing discretionary accruals and engage more in cash – based Earnings Management activities for fear of detection by the Auditors.

3. This study contributes to knowledge by showing that accrual – based earnings management is more likely to attract serious audit inquiry and regulatory scrutiny than real earnings decisions of quoted companies in contemporary times;

4. This study contributes to knowledge by integrating two streams of research in earnings management and audit quality which has been desperate and incongruent in several economies.

## SUGGESTIONS FOR FURTHER STUDIES

Further studies in the same or similar area to the present study should focus on:

1. Quoted companies in the financial services sector. Despite the reasons adduced, the non-inclusion of financial institutions in this study is a major constraint to the generalization of the findings of this study to all the quoted companies in Nigeria.

2. The financial data unquoted companies in Nigeria and other businesses located within the informal sector also need to be evaluated in order to be able to make general policies that will favourably affect such institutions and consequently the entire economy.

**CONCLUSION**

Many past empirical studies investigate the implications of auditor tenure and auditor independence on the performance of companies. The majority of these investigations are based on developed economies, while very little is empirically known about the implications, relationships and impact of auditor tenure and auditor independence on earnings management in emerging or transition economies like Nigeria.

This study has examined and documented evidences that are consistent with the relationship and effects which audit quality variables exerts on earnings management from the perspectives of discretionary accruals manipulations and the manipulations of economic operations of companies listed on the Nigerian Stock Exchange (NSE). Based on a sample of 342 company – year observations from the NSE for the fiscal years, 2006 to 2011, and using two of the commonly applied audit quality measures (Audit Fees and Auditor Tenure) a massive and all-inclusive multivariate analyses was conducted. The result showed that audit quality is significant and negatively related to earnings management measured by discretionary accruals of quoted companies in Nigeria.

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

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