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The Effect of Audit pricing on Earnings Management among Non-financial Listed Firms in Nigeria

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Abstract
This study investigates the effect of audit pricing, measured through normal and abnormal audit fees, on real earnings management (REM) in Nigerian non-financial listed firms. Using panel data from 50 firms listed on the Nigerian Exchange Group between 2013 and 2022, and employing Roychowdhury's (2006) real earnings management model, the study finds a statistically significant negative relationship between normal audit fees and REM, $\beta = -0.046$, $p = 0.0113$. This suggests that higher audit fees, reflecting better audit quality and effort, deter managerial manipulation of earnings. Audit tenure also negatively correlates with REM, indicating that longer auditor-client relationships may enhance audit effectiveness. However, firm age, size, and loss indicators show no significant impact. The findings support agency theory's premise that adequate audit remuneration mitigates agency conflicts by constraining managerial opportunism. Despite some contrasting literature, results emphasize the strategic importance of fair audit pricing to uphold financial reporting integrity. The study recommends that regulators enforce guidelines ensuring fair audit pricing linked to service quality, companies invest in high-quality audits as part of good governance, and auditors promote transparency in fee attribution to reinforce audit credibility. This research contributes empirical evidence to the nuanced relationship between audit fees and earnings management in emerging markets like Nigeria, highlighting audit pricing as a critical mechanism for enhancing audit quality and financial reporting transparency.

Keywords: Audit Pricing, Real Earnings Management, Normal Audit Fees, Abnormal Audit Fees, Nigerian Non-financial Firms.

1. Introduction

The audit function is conventionally regarded as a key mechanism to curb earnings management by providing an independent check on financial disclosures. However, the effectiveness of audit quality, particularly through audit pricing mechanisms such as audit fees, in mitigating earnings management has generated mixed empirical evidence. Audit pricing, commonly proxied by audit fees, reflects the economic value of audit services and is often linked to the quality of the audit. Higher audit fees may indicate more extensive audit procedures or higher auditor expertise, which theoretically should constrain earnings management (Bello et al. 2023). Conversely, excessive audit fees might raise concerns about auditor independence and potential collusion, thereby weakening audit effectiveness (Ajape & Adelowotan, 2024). In the Nigerian setting, studies have found that audit fees have a significant negative effect on earnings management, suggesting that higher fees paid to auditors are associated with reduced manipulation of earnings (Bello et al., 2023). This implies that firms paying more for audit services may receive more rigorous audits that deter earnings manipulation.

The interaction between audit pricing and earnings management has garnered significant scholarly interest, especially in emerging economies such as Nigeria. Audit pricing, typically decomposed into normal (expected) and abnormal (unexpected) audit fees, is believed to impact the extent of management's discretion over reported financial results (Haidar & Paradkar, 2017; Khalil & Li, 2022). Real earnings management, which involves altering actual business transactions to achieve certain earnings targets, is considered more challenging to detect than accrual-based manipulation (Srivastava et al., 2019).

Audit pricing, encompassing both normal and abnormal audit fees, plays a critical role in influencing the quality of audits and the extent of earnings management by firms. Despite extensive research on audit fees and earnings management, the relationship remains inconclusive, especially in emerging markets like Nigeria where institutional frameworks and market dynamics differ significantly from developed economies (Chi et al., 2011; Gandía & Huguet, 2020; Li Zhang, 2023). In the Nigerian context, the audit market is dominated by a few large firms, and audit fees vary widely depending on firm size, complexity, and risk (Onochie, 2011; Usman & Adekanye, 2023). However, empirical evidence on how audit pricing affects real earnings management—a form of earnings manipulation that involves operational decisions rather than accounting accruals—is limited and fragmented.

Studies conducted on Nigerian listed manufacturing companies have found a significant negative relationship between audit fees and earnings management, suggesting that higher audit fees improve audit quality and reduce earnings manipulation (Usman & Adekanye, 2023; Hadiza & Abba, 2024). Yet, these studies largely focus on accrual-based earnings management or specific sectors, with scant attention to abnormal audit fees and real earnings management across a broader set of non-financial firms. Moreover, the potential for audit fees to both reflect audit quality and simultaneously impair auditor independence complicates the interpretation of their effect on earnings management (Li Zhang, 2023).

Additionally, the evolving regulatory environment in Nigeria, including the enactment of the Financial Reporting Council Act and IFRS adoption, has altered audit practices and fee structures, but its impact on audit pricing and earnings management remains under-explored (Okolie & Agboma, 2018; Usman & Adekanye, 2023). This gap is critical because inadequate audit pricing may incentivize auditors to reduce effort, increasing the risk of undetected earnings manipulation, while excessive fees may compromise auditor objectivity.

Therefore, there is a pressing need to empirically investigate the effect of audit pricing both normal and abnormal audit fees, on real earnings management among Nigerian non-financial listed firms.

2. Literature Review

Empirical Evidence

Studies conducted on Nigerian non-financial listed firms consistently reveal a significant negative impact of audit fees (as a proxy for both audit quality and effort) on real earnings management (Kayode et al., 2019; Hadiza & Abba, 2024). Additionally, audit tenure emerges as a notable factor, with some evidence indicating that longer tenures may erode auditor independence and thus amplify earnings management (Kyriakou & Dimitras, 2018; Tzovas et al., 2023). Comparative evidence from other emerging markets aligns with the notion that the interplay between audit pricing (especially abnormal audit fees) and earnings management is context-dependent, shaped by institutional quality and regulatory environments (Nekhili & Cherif, 2020; Withana & Ajward, 2018).

Empirical evidence from Nigerian non-financial listed firms supports this theoretical expectation. For example, a recent study by Ogiriki and Egberibin (2023) found that audit fees have a significant negative effect on earnings management among Nigerian manufacturing firms, suggesting that higher audit fees are associated with lower earnings manipulation. This relationship is attributed to the increased audit effort and quality that higher fees finance, which constrain managerial discretion in financial reporting. Similarly, a study examining listed manufacturing companies in Nigeria reported that audit fees significantly reduce earnings management at the 5% significance level (Majaf, 2023).

A majority of Nigerian studies report a significant negative relationship between audit fees and earnings management, suggesting that higher audit fees enhance audit quality and reduce earnings manipulation. Usman and Adekanye (2023) examined 64 listed manufacturing firms from 2013 to 2017. They found that a one-Naira increase in audit fees reduces earnings management by 34%, indicating that adequate remuneration enables auditors to deploy better resources and exercise greater diligence. Ibrahim et al. (2020) showed that audit fees paid to Big 4 auditors significantly restrict real earnings management in Nigerian manufacturing firms, reinforcing the role of audit pricing in constraining managerial opportunism.

Egbunike et al. (2022) analyzed 75 non-financial firms from 2010 to 2019 and reported a significant negative effect of residual audit fees on real income smoothing proxies such as operating cash flow and production expenditure smoothing, indicating that higher audit fees reduce earnings management practices. Tijani et al. (2022) found that audit firm size and audit fees have significant negative effects on real earnings management in Nigerian manufacturing firms, further supporting the audit pricing–earnings management nexus.

Some studies suggest the relationship is more complex or context dependent. Ajape and Adelowotan (2024) found no significant effect of audit fees on real earnings management among selected non-financial firms, suggesting that audit fees alone may not sufficiently deter earnings manipulation without considering other audit quality dimensions. Owolabi and Ojo (2019) reported that while audit tenure and auditor independence significantly affect earnings management, audit firm size and audit fees showed statistically insignificant relationships, indicating that audit pricing may not always reflect audit quality or independence in Nigeria. Alu et al. (2022) emphasized that audit quality variables collectively explain a substantial portion of earnings management variance, but audit fees alone may not be a consistent predictor of discretionary accruals across Nigerian listed firms.

Han (2022) conducted a study on the factors that influence audit fees and the effect of earnings quality. The study used descriptive analyses, pooled regressions with industry-year fixed-effect, and annual regressions with data from UK-listed enterprises. The study found that the Big 4 premium is not significant and that auditor industry specialists charge the fee premium. Using descriptive statistics, Choi et al. (2021) investigated the differences between accrual-based and real profits management's impact on audit fees across international borders. According to the study, auditors generally charge a higher premium for real earnings management than for accrual earnings management. They also find that strong legal protections raise the audit fee premium for both real and accrual earnings management, with real earnings management seeing a larger increase in premium than accrual earnings management.

Gandıa and Huguet (2021) investigated the variations in audit fees and earnings management according to the type of audit. They proposed a linear regression model and analyzed the impact of the test variables. The study's findings indicated that while the interaction term has a positive correlation, the degree of earnings management is adversely correlated with both voluntary audits and audit fees. In a study of Malaysian firms, Iskandar et al. (2020) found that higher audit fees are associated with a lower likelihood of earnings management. Similarly, in a study of Chilean firms, Farfan and Basdeo (2018) found that higher audit fees are associated with a lower likelihood of earnings management. In contrast to this, Regression analysis was used by Lopo Martinez and Moraes (2017) to examine the connection between audit fees and earnings management in the Brazilian market. The study also suggested that the possibility of stating more aggressive earnings management occurs predominantly among firms that pay less than expected for audit services. The result demonstrated that audit firms that charge less for their service tend to be more relaxed regarding earnings management by their client companies.

Using an ex-post facto research approach, Ogiriki and Egberibin (2023) investigated the audit quality and earnings management of listed manufacturing enterprises in Nigeria. The study's findings demonstrate that audit tenure, audit fees, auditor industry specialization, and firm size (Big4) all had a significant and positive impact on earnings management. The report suggests that Nigeria's manufacturing sectors hire Big 4 firms and rigorously follow the requirement that auditors rotate their roles. The current research hypothesizes that there is a negative relationship between audit fees and earnings management in non-financial firms listed on the Nigerian Exchange Group. This hypothesis is pegged on the claim that high audit fees enhance audit quality, enable more accountability and reduce the tendency of management to engage in manipulative accounting practices.

Theoretical Review

Agency theory posits that audit fees serve as a mechanism to align the interests of managers and shareholders by enhancing audit quality. Adequate audit remuneration is expected to incentivize auditors to detect and report irregularities, thereby reducing earnings management. The agency theory forms the primary theoretical basis for examining the relationship between audit pricing and earnings management. This theory describes the contractual relationship between principals (shareholders) and agents (managers), where agents are entrusted to act in the best interests of principals. However, due to information asymmetry and divergent interests, managers may engage in opportunistic behaviors, such as earnings management, to further their own objectives at the expense of shareholders.

Agency theory posits that the separation of ownership and control leads to conflicts of interest, with managers exploiting their informational advantage. The resulting agency costs arising from monitoring, bonding, and residual losses can be mitigated through effective corporate governance mechanisms, including high-quality audit. Agency theory provides a robust theoretical foundation for examining the effect of audit pricing on earnings management among Nigerian non-financial listed firms. It explains how audit fees, as a proxy for audit quality and effort, can reduce agency conflicts by constraining managerial opportunism. The Nigerian empirical evidence corroborates this, showing that higher audit fees are associated with lower earnings management. Future research should continue to explore the interplay between audit pricing, auditor independence, and regulatory frameworks to deepen understanding of how audit markets can improve financial reporting quality in emerging economies.

3. Methodology

Research Design

This study adopts an ex-post facto research design, which is appropriate for examining existing data to assess causal relationships without experimental manipulation (Menard, 2002). The design enables the observation of audit pricing effects on earnings management over time, controlling unobserved heterogeneity and time-invariant firm characteristics. Panel data techniques enhance the efficiency and robustness of the estimates compared to cross-sectional or time-series analysis alone. The population comprises all non-financial companies listed on the Nigerian Exchange Group as of December 2022, totaling 107 firms. From this population, a purposive sample of 50 firms was selected based on criteria including continuous listing since 2012, no delisting or suspension, absence of mergers, uninterrupted operations, and consistent annual report publication (similar to criteria used by Ayoola et al., 2022). This sample size balances representativeness and data availability, consistent with prior Nigerian studies. Secondary data were collected from audited financial statements and NGX databases, ensuring reliability and accuracy (DeAngelo, 1981). Audit fees, total assets, and other financial indicators were extracted for the study period. The use of secondary data aligns with established research on audit pricing and earnings management in Nigeria (Usman & Adekanye, 2023; Ogundunmade, 2025).

Table 1: Measurement of Variables

Variables	Indicator	Measurements	Source	A priori Expectation
Dependents				
Earning Management	REM: CFO PRO EXP	A measure of earnings management that uses real earnings management activities.	Roychowdhury (2006) model	+/-
Independent				
Audit Price	Normal audit fees (NAF) Abnormal audit fees (ANF)	Natural Logarithm of Audit Fee; Different between (Audit Fees) AF and expected (Audit Fees) AF	Gerayli, et al. (2011)	+/-
Control				
Firm Size	SIZE	Natural Logarithm of Total Asset	Lisar et al. (2016); Ibrahim et al. (2023); Purwohandoko, (2017).	+/-
Loss	LOSSLAG	An indicator variable to assess whether the client reported a loss in prior year	Campa (2013)	+/-
Audit Tenure	AUDTEN	It is measured as the logarithm of auditors' tenure in years		+/-
Age of Firm	AGE	Number of years since the establishment of the firm.	Huynh & Petrunia, 2010; Kueng et al. (2014)	+/-

Source: Researcher's Compilations, 2025.

Using real earnings management, the models are:

$CFO = \beta_0 + \beta_1 NAF_{it} + \beta_2 ANF_{it} + \beta_3 SIZE_{it} + \beta_4 LOS_{it} + \beta_5 AUDTEN_{it} + \beta_6 AGE_{it} + \varepsilon$ ……………..…….. Eqn. 1

$PROD = \beta_0 + \beta_1 NAF_{it} + \beta_2 ANF_{it} + \beta_3 SIZE_{it} + \beta_4 LOSS_{it} + \beta_5 AUDTEN_{it} + \beta_6 AGE_{it} + \varepsilon$ ……... ….…….. Eqn. 2

$$EXP = \beta_0 + \beta_1 NAF_{it} + \beta_2 ANF_{it} + \beta_3 SIZE_{it} + \beta_4 LOSS_{it} + \beta_5 AUDTEN_{it} + \beta_6 AGE_{it} + \varepsilon \quad \text{Eqn. 3}$$

4. Results and Discussion

Table 2: Descriptive Statistics

	REM	NAF	AGE	SIZE	AUDTEN	LOSS
Mean	0.171	4.060	30.02	7.135	3.873	0.255
Median	0.129	4.079	35	7.1	3	0
Maximum	0.842	5.796	57	8.76	19	1
Minimum	0.003	2.301	1	4.21	1	0
Std. Dev.	0.146	0.591	13.578	0.862	2.779	0.437
Skewness	1.659	-0.038	-0.570	-0.124	1.658	1.121
Kurtosis	6.281	3.079	2.036	2.335	7.562	2.257
Jarque-Bera	450.973	0.250	46.181	10.446	658.495	115.534
Probability	0.000	0.883	0.000	0.005	0.000	0.000
Sum	85.240	2020.974	14921.000	3546.576	1925	127
Sum Sq. Dev.	10.641	173.528	91440.760	368.555	3831.014	94.547
Observations	497	497	497	497	497	497

Source: Author's Computation, 2025.

Table 2 gives a broad descriptive analysis of the main variables under study for audit market competition, audit pricing, and earnings management practices among firms listed in Nigeria. The results revealed that the mean value of real earnings management (REM) is 0.172, while the median stands at 0.129, thus implying variability in earnings management practice across the sample. REM has an extremely wide range, with a maximum value at 0.842 and a minimum value at 0.003, which already implies how different firms can be extreme in their approach to reporting their earnings. The average normal audit fee (NAF) is 4.066 with a median very close to the mean at 4.079, indicating a fairly centralized distribution of audit fees among the firms under study. A standard deviation of 0.592 shows that, though most of the firms are around the average fee, there exist notable deviations in the fees charged by different audit firms.

The average age of the firms in this study is 30 years, with a wide dispersion between just 1 year to as much as 57 years old, indicating established companies and new entrants into the market. Firm size by average total assets has been reported at a mean of 7.136 with a moderate spread since standard deviation stands at 0.862. This indicates that there is some diversity in firm sizes within the sample, which may affect the potential for earnings management due to differences in operational complexity and regulatory scrutiny.

The audit tenure, that is, the average time auditors have served one client- about 3.9 years, is a highly important variable, as longer tenure can interfere with auditor independence, and potentially affect earnings management practices. 25.6% of the sample firms reported a loss in the previous year, which is an indication of financial distress that may encourage managers to participate in earnings management in order to achieve a more positive financial image. The large skewness of REM (1.659) indicates that most firms are undertaking relatively low degrees of earnings management, and a few outliers exhibit more extreme practices. In comparison, the skewness of audit fees is insignificant, which shows a more symmetric distribution of audit fees. The kurtosis values further confirm this since REM has a significant peakedness and thus, heavy tails- that indicates the existence of extreme fluctuations in earnings management. Jarque-Bera statistics on the REM show that the distribution is significantly different to the normality (p = 0). This proves that the results are statistically significant.

Table 3: Fixed Panel Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
NAF	-0.046	0.018	-2.542	0.0113
AGE	0.0002	0.00049	0.507	0.6123
SIZE	0.002	0.013	0.209	0.8345
AUDTEN	-0.007	0.002	-3.174	0.0016
LOSS	0.011	0.015	0.69	0.4846
	Effects Specification			
Period fixed (dummy variables)				
R-squared	0.090	Mean dependent var		0.171
Adjusted R-squared	0.063	S.D. dependent var		0.146
S.E. of regression	0.141	Akaike info criterion		-1.040
Sum squared resid	9.681	Schwarz criterion		-0.913
Log likelihood	273.485	Hannan-Quinn criter.		-0.990
F-statistic	3.414	Durbin-Watson stat		1.210
Prob(F-statistic)	0.000027			

Source: Author's Computation, 2025.

The adjusted R-squared value further refines this estimate to 6.38%, indicating the model's relatively limited explanatory power. The F-statistics, with a value of 3.414 and a corresponding p-value of 0.000027, confirms that the regression model collectively has significant predictive capability. Normal audit fee (NAF) demonstrates a negative relationship with REM, indicated by a coefficient of -0.046 and a significant p-value of 0.0113, suggesting that higher audit fees correlate with lower levels of earnings management. Hence, we therefore, reject null hypothesis and accept alternative hypothesis that audit pricing has negative and significant effect on earnings management among non-financial listed firms in Nigeria. This finding points to the potential that increased audit costs enhance audit quality, thereby deterring managers from engaging in manipulative accounting practices.

Complementing this evidence, Kayode et al. (2019) confirmed the negative effect of audit quality on earnings management in the case of the Nigerian manufacturing sector, implying that there is a continuous scheme where increased audit fees enhance audit quality and restrict discretionary accounting behaviour. Similarly, study done by Ogiriki and Egberibin (2023) highlights that a higher audit fee has a positive relationship with audit quality and negative relation with earnings management which also confirms that more financial investment in audit leads to more surveillance and less creative accounting.

Nonetheless, though numerous studies converge to support the negative relation between audit fees and earnings manipulation, contradictory evidence also exists. For instance, Ajape and Adelowotan (2024) reported no significant impact of audit fees on real earnings management of the sampled companies.

This dissonance indicates that although audit fees play a substantial role, they might not be a panacea as the only tool to curb the earnings management problem. Other dimensions of audit quality (auditor independence and tenure) should actually be included in order to achieve a comprehensive measure of the integrity of financial reporting.

Moreover, these trends have been found in larger geographic regions around the world. For instance, studies from Spain by Gandía and Huguet (2021), and by Haidar & Paradkar (2017) from the UK claim that higher fees are associated with greater audit scrutiny and less earnings management, supporting the importance of a differentiated pricing model that reflects the quality of the audit service rendered.

Further, the variable representing audit tenure shows a negative coefficient of -0.007 with a statistically significant t-statistic of -3.174, evidenced by a p-value of 0.0016. This suggests that longer auditor-client relationships might reduce the likelihood of aggressive earnings management, reinforcing the argument for auditor independence and the rotation of audit firms. In contrast, the variable for firm age (AGE) has a negligible positive coefficient and is not statistically significant (p = 0.6123), indicating that the age of a firm does not have a meaningful impact on REM within this sample. Additionally, the model presents an R-squared value of 0.09, suggesting that approximately 9.02% of the variability in real earnings management can be explained by the independent variables included in the model.

Table 4: Diagnostic Test

S/N	Tests	Analytical Techniques	Results	Remark
1	**Cross-section dependence test**	Breusch-Pagan	F =3.897; P=0.0001	Panel effect is Suitable
2	**Hausman Test**	Correlated Random Effects - Hausman Test	F=13.786; P=0.0017	Fixed effect is appropriate
3	**Heteroscedasticity test**	Breusch-Pagan test	Chi = 1.092; p = 0.473	Free from the problem of Heteroscedasticity test
4	**Serial Correlation**	Breusch-Godfrey LM test	Chi = 0.357; p = 0.754	No Serial Correlation Problem

Source: Author's Computation, 2025.

5. Conclusion and Recommendations

The study examines the effect of audit pricing on earnings management for non-financial listed firms in Nigeria. Data was analyzed from 50 non-financial companies listed for the years 2012 and 2013. A negative relationship between audit pricing and earnings management was established with a coefficient of -0.046 at a statistical significance level of 0.0113. This implies that higher audit fees are associated with lower levels of earnings management. Reduced earnings management can be taken as an indicator of improved audit quality; hence, as firms pay more in audit costs, there is a stronger discouragement to practice manipulative accounting. The findings support the notion that appropriate audit pricing plays a critical role in upholding the integrity of financial reporting, ultimately contributing to greater transparency and accountability in financial disclosures. It becomes evident that the dynamics of audit pricing serve as a mechanism to mitigate agency conflicts between management and shareholders.

Agency theory suggests that managers, as agents, can fulfil their interests — possibly through earnings management — to the detriment of shareholders' interests. This suggests that paying higher audit fees will help as a monitoring incentive to put pressure on the managers' interest toward the direction of shareholders by increasing the cost of manipulating earnings. In the current study, it is shown that tiered pricing structures in professional audit engagements are an effective deterrence to earnings management practices and hence help in improving financial transparency.

The following recommendations were made:

i. The regulators and standard-setting bodies in Nigeria should come up with guidelines that would lead to fair pricing of audits, where firms will pay auditors according to the quality of service they provide. These are likely to strengthen the effectiveness of audits and consequently reduce the incidence of earnings management.
ii. Companies ought to invest in getting quality audit services not just to comply but also as part of their overall corporate governance regime, thus instilling a level of confidence among the investors and other stakeholders.
iii. The audit profession should be at the forefront in promoting initiatives that enhance transparency in the attribution of audit fees, which would help in elucidating the mutual connection between audit quality, fee rates, and integrity of the accounts. These are in line with the fiduciary duties that are entrenched in the agency theory.

Overall, the sophistication of the audit pricing incentives and the spread of knowledge about their importance can significantly increase accountability in the financial reporting process of non-financial listed companies in Nigeria.

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