

Effects of Audit Quality and Corporate Governance on Earnings Management of Quoted Deposit Money Banks in Nigeria

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Abstract—The stakeholders' pressure on corporate managers to maintain firm's profitability has created economic incentives for management to engage in earnings management practices. Therefore, this study examines the effects of audit quality and corporate governance on earnings management of quoted deposit money banks (DMBs) in Nigeria. This study specifically investigates the influence of audit tenure, audit fee, board independence, and board size on earnings management of DMBs. Explanatory research design was employed in carrying out the study while secondary data were sourced from the annual reports and accounts of all the 15 quoted DMBs in Nigerian Stock Exchange as at December 31, 2015 for a period of 10 years covering from 2006 to 2015. The data obtained for the study were analyzed using panel regression analysis approach. The findings reveal that board independence has a negative significant effect on earnings management at a 5% level of significance ($p=0.002$), while audit fee has a positive significant effect on earnings management at a 5% level of significance ($p=0.013$) and audit tenure has a negative significant effect on earnings management of DMBs at a 5% level of significance ($p=0.003$). Surprisingly, board size was statistically not significant at a 5% level of significance ($p=0.086$). The study concludes that high audit quality and sound corporate governance could improve the earnings quality of DMBs. Hence, the study recommends that the authorities saddled with the responsibility of banking supervision in Nigeria such the Securities and Exchange Commission (SEC) and CBN to advise the National Assembly in Nigeria to pass into law the three years professional requirement for audit tenure.

Keywords—Audit quality, audit tenure, audit fee, board independence, corporate governance, earnings management.

I. INTRODUCTION

THE consequential audit failure in Enron's case of 2002 has brought about series of regulations and guidelines in the accounting profession and other related professions such as the 2002 US Sarbanes Oxley's, the 2003 Nigerian Code of Corporate Governance, and the UK Financial Reporting Council, just to mention a few. However, despite the aftermath of the regulations and reporting guidelines and significant progress in the quality of audit service; there are still reported cases of audit and corporate failure perhaps stemming from earning management practice, particularly in Nigeria (Cadbury Nigeria Plc, Intercontinental Bank Plc, Savannah Bank and Bank PHB) and also across Europe, Australia and the United States [25], [22], just to mention a few. Although it has not

been proved by any detailed investigation that these audit failures were due to low quality of audit service or weak code of corporate governance stemming from earnings management practice, it could however reasonably be suspected to be the contributing factor. These corporate scandals have discouraged the public from having confidence in audit reports [1]. Meanwhile, the demand for external audit was as the result of the agency problems arising from the asymmetric information between banks' shareholders and banks' management. Accounting records have indicated that the existence of asymmetric information between shareholders and management underpin the practice of earnings management in companies [13]. Earnings management occurs when information asymmetry exist between shareholders and managers, shareholders have inadequate access to relevant information to monitor manager's actions. Earning management is a strategy used by the management of a firm to deliberately manipulate the firm's earnings so that the figures match a pre-determined benchmark. This practice is carried out for the purpose of income smoothing [18].

Although the different methods used by managers to smooth earnings can be very complex and confusing, the vital point to remember is that the driving force behind managing earnings is to meet a pre-determined target [18]. One of the methods of earnings management is discretionary accruals accounting (which also serve as the proxy for earnings management in the literature and in this study) which gives opportunities of discretion to management in determining the actual earnings of a bank. However, earnings are the powerful indicators of banking business activities. Since a bank's stock is measured by the present value of its future earnings, investors and analysts look to earnings to determine the attractiveness of a particular stock. Banks with poor earnings prospects will typically have lower share prices than those with good prospects [27], [23], [16]. So, earnings management plays a key role to determine the share price of a bank as well as direct resource allocation in capital markets. Manipulation of accounting records by the preparer of financial statement through recording a fictitious inventory and hiding liabilities even in the face of audited financial reports may be attributable to the stakeholders' pressure on corporate managers to maintain profitability [37]. Furthermore, since the values of the banks are linked to the reported earnings figures, it creates economic incentives for management to engage in earnings management. In the context of these challenges and foregoing analysis motivated this study to integrate both

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corporate governance and audit quality to determine the level (extent) of earnings management of DMBs in Nigeria. However, the integration of both audit quality and corporate governance into a single study has not been given attention in Nigeria; hence, this study fills a gap in the literature since the study is specifically focused in Nigeria.

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

A. Conceptual Framework

There is no single universally accepted definition of earnings management (also called creative accounting) in the literature [24]. Reference [31] defines earnings management as “a purposeful intervention in the financial reporting process, with the intent of obtaining some private gain”. While [16] modified this definition and came up with this description of earnings management; “Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting statements”. Although it is clear that earnings management is a process intended by the management of a firm, it is less obvious whether the intent could be solely opportunistic [34].

Reference [32] defined earnings management by the choice of accounting policies so as to achieve some specific managers' objective. This behavior may have a significant effect on the quality of information provided to investors. Reference [7] also defines earnings management as any attempt to cook/doctor or tailor financial accounting reports to a given desired level. According to him, earnings management is paradoxical of accountants and relates it to the recent era of corporate failures and loss of confidence by investors on both financial reports and auditors. This means that earnings management is the manipulation of financial statements by managers, using accounting choices, estimates and methods, to achieve some objectives that are largely in conflict with the underlying economic status of the firm. Therefore, this study defines earnings management as the process of information asymmetry which subsists between shareholders and management in order to smooth the earnings in attaining or sustaining a performance benchmark.

Conceptually, various methods for the detection of earnings management have been documented. “Empirical studies have found managers engage in earnings management through changing accounting choice, real transactions, total accruals/discretionary accruals, specific accruals, earnings distributions approach and income smoothing” [35]. Of all these methods, the total accruals approach seems to be the one that has caught the attention of researchers the most. This is due to the fact that it is the most damaging to the usefulness of accounting information because investors are wary of such accruals [2]. Different incentives to manage earnings are widely discussed in the literature. According to [8], he opines that it is the attempt to enhance shareholders' value and to maximize executive compensation through income smoothing

and earnings management.

B. Overview of Audit Quality

Reference [17] and [23] suggested that there have been a series of attempts to define “audit quality” in the literature. Nevertheless, none has given a definition that has been universally acceptable. However, audit quality could simply be put as an unobservable and multi-faceted concept. Conceptually, [10] defined audit quality as the market-assessed joint probability that the auditor discovers and truthfully reports material misstatement, misrepresentation and omissions detected in a client's accounting statements. Meanwhile, audit quality can also be explained from an agency theory perspective. Agency theory is a known practice in the literature that defines the inter-relationship between the principal (shareholders) and the agent (managers). However, potential conflicts of interest between both parties maybe as a result of different goals of the parties, and the managers may not act on the best interests of the shareholders due to separation of ownership and control [9], [19]. Reference [13] confirmed that this agency problem leads to the demand for external auditing. The role of the auditing profession is to help reduce information asymmetry on accounting figures and to minimize the perceived loss resulting from managers' opportunism in financial reporting [1]. Essentially, auditing is used to provide the needed assurance for financial statement users (especially investors) when relying on audited financial statements. Reference [10] noted that audit quality consists of two components: auditor competence and auditor independence. Deterioration in audit quality in a short tenure audit may be due to either to lack of competence or loss of independence. Finally, quality of audit is expected to minimize the extent of a firm's fraudulent manipulations of reported income. High auditing quality diminishes information asymmetry and minimizes uncertainty concerning earnings. Therefore, high audit quality and quality assurance audits are expected to provide sufficient constraints on earnings management.

Empirically, [13], [24] argued that high audit fees have impaired audit independence, which leads to poor audit quality, and tolerate greater accruals based earnings management. However, [12] argued that high profile audit companies usually charge their clients based on the number of working hours. However, high audit fees imply high audit input, which gives a sense of duty to auditors to provide better quality to their clients. Hence, the study adopted two audit quality variables formulated into hypotheses as follows:

- *Ho₁: Long or short tenure of an audit firm has no significant influence on the earnings management of DMBs in Nigeria;*
- *Ho₂: Audit fees have no significant influence on the earnings management of DMBs in Nigeria.*

C. Overview of Corporate Governance

The modus operandi of corporate governance is rules, practices and processes through which a company is directed and controlled to minimize agency costs and align the interest

of both management and investors [21].

Reference [33] narrated the role of corporate governance structure in financial reporting as a process of reducing the divergence of interests between shareholders and managers and also to ensure compliance with GAAP and maintain the credibility of corporate financial statements. The emergence of mega banks in the post consolidation era prompted the Central Bank of Nigeria to issue a new code of corporate governance which became operative in 2006. In the same vein, the Nigerian Securities and Exchange Commission (SEC) published the revised editions of the Code of Corporate Governance in 2009, 2011, and 2014, after consultations with other regulatory bodies. The new code was issued to address the weaknesses of the 2003 code and to improve the mechanism for its enforceability. It requires the separation of the position of the managing director from that of the chief executive officer. Also, the code recommends that the number of non-executive directors should be more than that of executive directors subject to a maximum board size of 20 directors.

Reference [21] opines that well-structured corporate governance mechanisms are expected to reduce earnings management because they provide effective monitoring of management in the financial reporting process. Also, this study adopted two variables of corporate governance which forms these hypotheses stated below:

- *H₀₃: Board independence has no negative significant relationship with the earnings management of DMBs in Nigeria;*
- *H₀₄: Board size has no significant relationship with earnings management of DMBs in Nigeria.*

D. Empirical Framework

Reference [9] assessed the relationship among audit quality, earnings management and financial performance of Malaysian public listed companies. Multiple regression model was used in the data analysis. The findings reveal that audit quality does not prevent earnings management practices in industrial and consumer products companies in Malaysia probably due to the difference in audit environment.

Reference [4] explored the relationship of board structure with earning management for companies listed in Portugal. Board structure was measured by the board size, board composition and board monitoring committees. Earning management was used as a dependent variable in this study. It was calculated through the discretionary accruals by using the Jones model. Ordinary Least Squares (OLS) regression test was applied to identify the relation of board structure and earning management for 34 firms from the non-financial sector for five years covering the years 2002 to 2007. The study indicated the inverse association between the variables of board independence composition and discretionary accruals. Moreover, the study found no evidence on the association of audit committee and earning management.

Reference [13] studied the impact of audit quality on earnings management based on evidence from Iran, and used OLS regression analysis method for their estimation. Their

results argued that high audit fees have impaired audit independence, which leads to poor audit quality, and tolerance of greater accruals based earnings management.

In the United States, [21] studied audit quality, corporate governance and earnings management. The study employed a meta-analysis statistical approach. The findings reveal that the independence of the board of directors and its expertise has a negative relationship with earnings management. Similar negative relationships exist between earnings management and the audit committee's independence, its size, expertise, and the number of meetings. The audit committee's share ownership has a positive effect on earnings management. For audit quality, auditor tenure, auditor size, and specialization have a negative relationship with earnings management. Auditor independence, as measured by fee ratio and total fee, is also a deterrent to earnings management.

In the UK, [29] examined the association between board composition and earnings management between the pre- and post-Cadbury periods. They used OLS regression analysis method for estimation. The study reveals the presence of accrual management to meet earnings targets in both periods. However, only the post Cadbury period shows less income increasing accrual based earnings to prevent earnings losses or declines when the proportion of non-executive directors is high. The findings show the impact of independent outside directors on preventing earnings management in the UK.

Reference [15] examined the relationship between audit fees and discretionary accruals in a sample of Australian and firms, in which the results showed a positive association between financial reporting quality (discretionary accruals) and audit fees, thus disputing the belief that audit fees erode independence. Also, [38] examined the characteristics of the board in limiting earnings management using discretionary current accruals to measure earnings management for a sample of 282 US firms for the period 1992 to 1996. The study observed that earnings management is less likely to happen in firms with larger boards.

Reference [6] studied the effect of audit quality on earnings management. OLS regression was used for estimation technique and the results revealed that audit quality is negatively related to income-increasing discretionary accruals, which indicates that high audit quality is associated with low information asymmetry.

Reference [3] examined the impact of audit quality on the earnings management of listed DMBs in Nigeria. The study employed secondary data in a sample of 10 listed DMBs in Nigeria for a period of eight years (2006-2013). The study used the OLS regression technique of data analysis and found that audit quality had a significant impact on the earnings management of listed DMBs in Nigeria during the period of the study. The study also found that audit firm size and joint audit services have a significant negative impact on the earnings management of listed DMBs in Nigeria. Similarly, the study found that auditor financial dependence has significant positive impact on earnings management of listed DMBs in Nigeria.

Reference [36] studied the effect of corporate governance

mechanisms on the earnings management of listed firms in Nigeria. OLS regression was employed for estimating the data collected from the annual reports of the selected firms. Findings from the study revealed that board size and board independence have a significant negative effect on earnings management (proxied by discretionary accruals). On the other hand, CEO duality had a significant positive impact on earnings management for the sampled firms in Nigeria.

Reference [28] studied the corporate governance determinants of earnings management based on evidence from Nigerian quoted companies. They employed binary regressions method for estimation. The major finding reveals that quoted companies in Nigeria prefer to adopt absolute high earnings management practices to low earnings management practices.

Reference [24] examined auditor tenure, auditor independence and accrual – based on the earnings management of quoted companies in Nigeria applying an all-inclusive multivariate method of analysis. The findings show that audit tenure and auditor independence have significant effects and relationship with the extent of discretionary accruals of quoted companies in Nigeria. The study specifically argued that high audit fees have impaired audit independence, which leads to poor audit quality, and tolerance of greater accruals based earnings management.

Reference [26] examined the impact/ relationship between audit quality and earnings management represented by companies' discretionary accruals manipulations in Nigeria. OLS regression technique was used in estimating the archival data that was extracted from the annual reports of 57 quoted companies in Nigeria between 2006 and 2011. Audit Firm Size, Audit Fees, Auditor Tenure and Audit Client Importance served as audit quality proxies. The amount of Discretionary Accruals (DAC) was used to measure earnings management. The results showed that audit quality was significant and negatively related to the amount of DAC of quoted companies in Nigeria.

III. METHODOLOGY

A. Model Specification

The dependent variable of the study is discretionary accrual used as a proxy for earnings management. However, based on prior literatures, it was observed that the modified Jones model is the most popular and frequently used model to detecting and addressing issues relating to management discretionary behaviors. The model was adopted because it is easier to manage earnings via the accrual method of accounting than cash basis. In addition, the cash flows statement approach is adopted in this study for the calculation of total accruals because it gives an accurate account of accruals than the balance sheet approach. Total accruals are calculated as net income before extraordinary items minus cash flows from operations [6].

This adoption is consistent with other previous studies, such as [38], [4], [26], [36]. This study utilizes the cross-sectional [20], model as modified by [11], in order to derive a measure

of discretionary accruals as follows:

$$TA_{it} / A_{it-1} = \beta_1 (1 / A_{it-1}) + \beta_2 (\Delta REV_{it} - \Delta REC_{it} / A_{it-1}) + \beta_3 (PPE_{it} / A_{it-1}) + \mu_{it} \quad (1)$$

where: TA_{it} = Total accruals in year t for firm i . ΔREV_{it} = Revenues in year t less revenues in year $t-1$ for firm i (change in revenue). ΔREC_{it} = Receivables in year t less receivables in year $t-1$ for firm i (change in receivables). PPE_{it} = Gross property, plant, and equipment in year t for firm i (property, plant & equipment). A_{it-1} = Total assets in year $t-1$ for firm i (total assets for the previous year). $\beta_1, \beta_2, \beta_3$ = Represents firms specific parameters. μ = Residual value which is the error term that represents the firm specific discretionary portion of accruals. Thus, the lower the value of the discretionary accruals, the higher the value of earnings quality and vice-versa; in other words, the magnitude of discretionary accruals is low when it is closer to zero. For more understanding of the formula, Total Accruals (TA) = Discretionary accrual (DA) + Non-discretionary accrual (NDA).

Reference [30] stated that studies that establish causal relationships between variables may be termed explanatory studies. They emphasized that this has to do with studying a situation or a problem in order to explain the relationships between variables. Additionally, this study used quantitative approach to investigate the stated objectives. This study made use of panel data extracted from audited annual reports and accounts of the sampled banks for a period of 10 years covering the period from 2006-2015. The population of the study consisted of the quoted 15 DMBs in Nigeria as at 31st December, 2015 for a period of 10 years covering the period from 2006-2015 resulting in 150 bank accounting - year observations. This paper studied all of the 15 quoted DMBs in Nigeria as at the time of this study; therefore is no need of sample size. The data collected were analyzed using panel regression method of estimation. The regression technique is adopted because it is the suitable technique for examining the relationship between variables [5].

There appears to be no agreement on the metric for the measurement of audit quality and corporate governance construct hitherto. However, the study adopted the ones that give inconsistent results for further empirical clarification. The independent variables in this study are audit quality and corporate governance. The audit quality variables adopted for the study includes audit tenure and audit fee, while the corporate governance variables adopted for the study include board independence and board size. The choice of the independent variables was informed by previous studies such as [26], [36], [9], [28].

This study employs panel regression analysis to test the relationship between the dependent variable and the identified independent variables. The model for the study is specified as:

$$DA_{it} = \beta_0 + \beta_1 AT_{it} + \beta_2 LNAF_{it} + \beta_3 BIND_{it} + \beta_4 BDS_{it} + \beta_5 LNBS_{it} + \beta_6 BLEV_{it} + \mu_{it} \quad (2)$$

where: DA = Discretionary accrual, AT = Audit tenure, AF = Natural Log of Audit fee, BDS = Board size, BS = Natural Log of Bank size, BLEV = Bank leverage, β_0 = Intercept, β_{1-6} = Coefficients to be estimated, μ = Error term, $i-t = i$ and t represent all 15 quoted banks and the 10-year time period, respectively.

B. Measurement of Variables

Discretionary accruals are measured as total accrual - non discretionary accrual; audit tenure, short term (short=0) if the client had been audited by the firm for a maximum of three years and long term (long=1) if it is above three years; audit fee as natural log of audit fee; board independence as proportion of non-executive directors to executive directors on the board; board size as the total number of directors on the board; bank size as the natural log of the bank's total assets; and bank leverage as the total debt/equity.

IV. DATA PRESENTATIONS, RESULTS AND DISCUSSIONS

TABLE I
DESCRIPTIVE STATISTICS OF THE VARIABLES

Observations	Mean	Std. Dev.	Minimum	Maximum	
DA	150	0.1492	0.1496	0.0020	0.7622
AT	150	0.4267	0.4963	0	1
(LnAF)	150	11.5634	0.6344	9.9035	13.0103
BIND	150	0.5745	0.0630	0.4000	0.7273
BDS	150	14.4933	2.9849	7	25
LnBS	150	20.1937	1.0845	15.3619	22.2277
BLEV	150	6.3852	3.8309	7.2000	34.7000

As shown in Table I, DA has a mean value of 0.1492 with maximum and minimum values of 0.7622 and 0.0020, respectively. This implies that the average discretionary accruals of the quoted DMBs in Nigeria for the period 2006–2015 was 14%, indicating a relatively low presence of accruals manipulation among the DMBs in Nigeria. The mean value of DA also implies that on average, the sampled banks manage accruals downward (income-decreasing accruals). The mean value of AT was 0.4267, which suggests that only 42% of the banks have engaged the services of an audit firm for a maximum period of three consecutive years, while 58% of banks engaged an audit firm above the three year audit tenure. More so, AF was observed to have a mean value of 11.56337 and a standard deviation of 0.634347, indicating clustering of audit fees for the distribution around the mean value. The maximum and minimum are 13.0103 and 9.903487, respectively. Observably, BIND has a mean value of 0.5745, indicating that the board independence status stood at 57% which implies that there are a greater proportion of non-executive directors and independent directors than executive directors on the board with maximum and minimum values of 0.7273 and 0.4000, respectively. Furthermore, BDS has a mean value of 14.4933 with maximum and minimum numbers of board size stood at 25 and 7, respectively, which suggests that it is in the range specified by the corporate governance code in 2003 to be a minimum of six and maximum of 20. The average value of BS measured by the natural log of banks' total assets was 20.1937 with maximum

and minimum values of 22.2277 and 15.3619, respectively. The mean value of BLEV was 6.3852 indicating the banks in the study were highly levered with maximum and minimum values of 34.7000 and 7.2000, respectively.

TABLE II
CORRELATION MATRIX

	AT	LnAF	BIND	BDS	LnBS	BLEV
AT	1.0000					
LnAF	0.3463	1.0000				
BIND	-0.0791	-0.1538	1.0000			
BDS	0.0835	0.1072	-0.1383	1.0000		
LnBS	0.0582	0.5344	-0.0087	0.4312	1.0000	
BLEV	-0.0629	0.0243	-0.1162	0.0742	0.0560	1.0000

Table II depicts the correlation matrix of the independent and control variables of this study. Correlation between the same variable is one, a correlation value of 0.5 and above implies strong correlation, while below 0.5 implies weak correlation. A positive sign implies direct correlation, while a negative sign implies indirect correlation. Hence, this is to measure the linear relationship between the variables DA, AT, LnAF, BIND, BDS, LnBS and BLEV. This correlation matrix reflects the relative strength of the linear relationship between these explanatory variables. According to [5], multicollinearity could only be a problem if the pair-wise correlation coefficient among the regressors is above 0.80.

TABLE III
VARIANCE INFLATION FACTOR FOR MULTICOLLINEARITY

VIF	Variable	1/VIF
1.20	AT	0.8365
1.76	LnAF	0.5678
1.08	BIND	0.9249
1.33	BDS	0.7505
1.87	LnBS	0.5349
1.02	BLEV	0.9758
1.38	Mean VIF	

Table III shows the variance inflation factor of multicollinearity for the detection of a possible strong relationship between independent variables. An implicit assumption that is made when using the panel least square estimation method is that the exogenous variables are not perfectly correlated or near perfect correlation with one another. As a general rule (of thumb) which says that the higher the VIF, the more likely there is multicollinearity. Reference [14] states, the closer the value to zero, the greater the degree of multicollinearity. However, from the result, the value of the independent variables exceeds 1; therefore, there is an absence of multicollinearity among the variables as indicated by the VIF of each variable falling below 10, and the average VIF also being less than 10.

Hausman test was conducted to check which model is appropriate between fixed effects and random effects. The result of the Hausman test revealed that the random-effects model is appropriate, since the probability value of 0.8147 is greater than the 0.05 level of significance (see Table IV). The

study further double checks with the use of the Breusch and Pagan Lagrangian multiplier test to determine the model that is appropriate between the pooled OLS model and random-effects model. The results confirmed that pooled OLS is appropriate, as indicated by a probability value of 0.4301 which is greater than the 0.05 level of significance (see Table IV). The Breusch and Pagan Lagrangian multiplier test is used to test for the presence of significant variation among the cross-sections in panel regression.

TABLE IV
REGRESSION RESULTS

Variable	Pooled OLS	Fixed Effect Model	Random Effect Model
Constant	0.9544 (0.001)*	0.9544 (0.001)*	0.9084 (0.002)*
AT	-0.2833 (0.003)*	-0.0838 (0.008)*	-0.0837 (0.007)*
LnAF	0.0615 (0.013)*	0.0721 (0.006)*	0.0636 (0.009)*
BIND	-1.4461 (0.002)*	-0.9446 (0.001)*	0.9016 (0.001)*
BDS	-0.0507 (0.086)	-0.0109 (0.031)*	-0.0109 (0.031)*
LnBS	1.063 (0.064)	0.1028 (0.000)*	0.1028 (0.004)*
BLEV	-0.104 (0.024)*	-0.0114 (0.005)*	-0.0114 (0.005)*
F-Statistic	3.62 (0.0023)*	2.97 (0.0095)*	
Wald X ²			20.86 (0.0019)*
Hausman Test		2.95 (0.8147)	
Breusch and Pagan	0.03		
Lagrangian Multiplier Test	(0.4301)		

*Denotes 5% level of significance. () denotes Prob., while the value denotes coefficients of the variables.

Pooled OLS regression assumed that the cross-sections exhibit no significant variation across entities; that is, no panel effect. This implies that there is similarity in the earnings management of all the quoted banks in Nigeria. Since Nigerian banks operate in an oligopoly market with similar but differentiated products and services, their earnings behavior and management will therefore equally follow the behavior of firms in an oligopoly market with bandwagon effect. Thus, this study accepts the null hypothesis that pooled OLS is appropriate. Therefore, the discussions of the results are based on descriptive statistics and the pooled OLS regression results of the effect of audit quality and corporate governance on the earnings management of DMBs in Nigeria reported in Table IV. The R² value of 0.6316 (63%) implies that 63% of fitness was observed in the sample regression line. More so, 63% of the total variation in the earnings management of the sampled DMBs discretionary accruals is jointly explained by the independent and control variables (DA, AT, LnAF, BIND, BDS, LnBS and BLEV). The F-statistic (6, 143) = 3.62 and P-value (0.0023) indicates strong statistical significance at the 0.05 level of significance, and the enhanced reliability and validity of the model.

Using the pooled OLS estimation results, it is observed that the effect of AT on the level of discretionary accruals is

negative (-0.2833) and statistically significant with a P-value of 0.003 at a 5% level of significance. This suggests that short audit tenure results in greater earnings quality and erodes the familiarity threat with a client, while the long audit tenure creates learned confidence in the client (familiarity threat).

The effect of audit fees on the level of discretionary accruals is positive (0.0615) and statistically significant with a P-value of 0.013 at a 5% level of significance. This concurs with *a priori* expectation that there is positive relation between AF and DA. Hence, the study accepts the alternate hypothesis on audit fees. This implies that high audit fees impose greater threat to an auditor's independence and hence greater opportunities for accrual manipulations.

BIND has a negative (-1.4461) effect on the level of discretionary accruals of the sampled DMBs in Nigeria, and is statistically significant with a P-value of 0.002 at a 5% level of significance. This concurs with *a priori* expectation that there is negative relation between BIND and DA. Hence, the study fails to accept the null hypothesis (H₀₃). Surprisingly, the effect of BS on the level of discretionary accruals of the sampled DMBs in Nigeria is equally negative (-0.0507) but statistically not significant with a P-value of 0.086 at a 5% level of significance. Similarly, the effect of BLEV on the level of discretionary accruals of the sampled DMBs in Nigeria is negative (-1.0635) and statistically not significant with a P-value of 0.063 at a 5% level of significance. The effect of bank size on the level of discretionary accruals of the sampled DMBs in Nigeria is positive (0.1042) and statistically significant with a P-value of 0.024 at a 5% level of significance. This implies that an increase in the asset size of the bank creates more opportunities for accruals manipulation.

V. CONCLUSION AND RECOMMENDATIONS

From the findings, the study concluded that audit quality and corporate governance affect earnings management. It would therefore be reasonable given the above findings to conclude that high audit quality and corporate governance effectiveness have negative and significant effects to minimize earnings management practice in DMBs in Nigeria. Further conclusions were that the shorter audit tenure will lead to higher earnings quality, while an increase in audit fees will lead to an increase in earnings management, and an increase in board independence will lead to a decrease in earnings management. The study concludes that audit quality and corporate governance are negatively related with earnings management. This paper recommends as follows:

The Securities and Exchange Commission (SEC) should adopt the Sarbanes Oxley's Act, 2002 audit tenure of five years. Alternatively, the SEC should encourage the National Assembly in Nigeria to pass into law the three years professional requirement for audit tenure in Nigeria. SEC code of corporate governance stance of a 10-year maximum for audit tenure in Nigeria gives room to the familiarity threat in audit quality, unlike the Sarbanes Oxley's Act and UK Financial Reporting Council guidelines, which peg audit tenure to be 5-years and 7-years, respectively.

The study also recommends that bank supervisory and

regulatory authorities such as the Central bank of Nigeria and Nigeria Deposit Insurance Commission should increase its surveillance in the areas of auditor remunerations in order to avoid arbitrary audit fees paid by clients.

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