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Audit Quality, CEO Ownership, and Earnings Management: An Empirical Analysis of Listed Non-Financial Services Firms in Nigeria

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Abstract

The primary objective of this study was to examine the moderating effect of Chief Executive Officer (CEO) share ownership on the relationship between audit quality and earnings management in Nigeria's listed non-financial services firms, covering the period from 2013 to 2022. A sample of 72 firms was selected, with real earnings management employed as the proxy for the dependent variable. The study adopted a correlational and ex post facto research design, utilizing secondary data obtained from firms' annual reports and the Nigerian Exchange Group website. Descriptive statistics and panel multiple regression analyses were conducted, with the random effects model and generalized least squares estimation applied for robustness. The findings reveal that audit quality has a negative and significant effect on earnings management, while CEO share ownership exerts a positive and significant effect. However, the moderated regression model indicates that CEO share ownership does not significantly moderate the relationship between audit quality and earnings management. The study concludes that CEO ownership levels do not influence how audit quality mitigates earnings management in Nigeria's non-financial sector. Consequently, it recommends that regulatory efforts to curb earnings management should prioritize strengthening external audit quality and enforcing rigorous audit standards, rather than relying on CEO ownership structures as a corporate governance mechanism. Firms are advised to consistently maintain high audit quality

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standards to enhance the credibility of financial reporting irrespective of CEO ownership levels.

Keywords: Real earnings management, audit quality, agency theory, leverage.

INTRODUCTION

Earnings management stands as a core concern for the financial reporting and corporate governance communities within emerging economies, particularly in Nigeria. Earnings management consists of deliberate financial report alterations made by managers whose purpose is reaching specific financial outcomes while pursuing earnings targets or stock price modifications (Healy & Wahlen, 1999). Financial practice manipulations destroy financial documents' reliability and generate stakeholder misinterpretations, which lead to market efficiency losses and investor trust reduction.

The quality of audit operations constitutes a universal means for minimizing earnings management activities. Audits of superior quality elevate financial report credibility because they verify that documents contain no major misstatements caused by either fraud or mistakes (DeAngelo, 1981). Effective external auditing discourages management from opportunistic financial reporting through multiple cited studies (Francis, 2004; Gul et al., 2003). Research within different jurisdictions produces opposing conclusions about the audit quality earnings management relationship because of contextual and firm-level elements (Piot & Janin, 2007).

The relationship between audit quality and earnings management is moderated by the extent of the Chief Executive Officer's (CEO) ownership of shares within the organization. When CEOs hold substantial equity share ownership, it becomes more likely their objectives will align with shareholders, thus minimizing agency costs and earnings management (Jensen & Meckling, 1976). CEO ownership control extends beyond a certain point because it creates self-serving opportunities that threaten the effectiveness of external auditing practices, according to Morck et al. (1988). This duality in theoretical perspectives necessitates empirical inquiry, especially in less developed economies with weaker institutional frameworks.

In Nigeria, the corporate governance landscape has witnessed significant reforms aimed at enhancing transparency and accountability in listed companies. The efforts by the Financial Reporting Council of Nigeria (FRCN), the Securities and Exchange Commission (SEC), and the Central Bank of Nigeria (CBN) are aimed at improving audit quality and financial reporting standards. Despite these reforms, earnings management

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remains prevalent among Nigerian firms (Uwuigbe et al. 2014), raising concerns about the effectiveness of current governance mechanisms. Listed non-financial services firms provide a suitable setting for this investigation due to their diverse ownership structures and critical role in the Nigerian economy. Exploring the moderating role of CEO share ownership in the audit quality earnings management nexus could offer valuable insights into how ownership incentives affect financial reporting behavior and the efficacy of external audits. This study, therefore, aims to empirically examine the moderating effect of CEO share ownership on the relationship between audit quality and earnings management among listed non-financial services firms in Nigeria.

Earnings management continues to be a critical concern for stakeholders in financial reporting, especially in developing countries like Nigeria, where institutional frameworks are often weak. Managers use discretionary accounting choices to manipulate earnings, sometimes within the bounds of accounting standards, to mislead investors or achieve performance benchmarks (Healy & Wahlen, 1999). This practice has a direct impact on the credibility and reliability of financial information provided to stakeholders.

Recent empirical evidence suggests that earnings management is widespread in Nigeria. For instance, Olayinka and Oluwamayowa (2020) reported that approximately 68% of listed Nigerian firms engaged in earnings smoothing practices between 2012 and 2018. Similarly, Adegbie, Olayinka, and Faboyede (2021) found that discretionary accruals, a proxy for earnings management, accounted for over 55% of total accruals in the financial statements of selected Nigerian firms. These figures highlight a systemic challenge in Nigeria's corporate reporting environment, despite the existence of various regulatory interventions and governance reforms.

Audit quality is widely recognized as a key mechanism for reducing earnings management. High-quality audits increase the likelihood of detecting and preventing financial misstatements (DeAngelo, 1981; Francis, 2004). However, audit effectiveness in Nigeria has been questioned due to factors such as auditor independence, rotation practices, and the dominance of non-Big Four firms in the audit market. According to the Financial Reporting Council of Nigeria (FRCN, 2022), only 22% of listed companies are audited by Big Four audit firms, while the remaining 78% are audited by smaller firms with potentially lower audit quality standards. This imbalance raises concerns about the ability of audits to act as effective deterrents against earnings manipulation.

Furthermore, internal corporate governance mechanisms, such as CEO share ownership, can influence how audit quality affects earnings management. The alignment

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hypothesis posits that when CEOs hold equity in their firms, their interests are more aligned with shareholders, thereby reducing opportunistic behavior (Jensen & Meckling, 1976). In contrast, the entrenchment hypothesis suggests that high ownership concentration can empower CEOs to override monitoring mechanisms, including audits, to pursue personal gains (Morck, Shleifer, & Vishny, 1988). The average CEO ownership among listed non-financial firms in Nigeria has increased from 9.4% in 2015 to 15.7% in 2022 (Nigerian Exchange Group [NGX], 2023), indicating a rising trend in insider control that may have implications for corporate governance effectiveness.

Despite the growing recognition of these dynamics, limited empirical research in Nigeria has examined the interactive effect of CEO share ownership on the relationship between audit quality and earnings management, especially in the non-financial sector, which accounts for over 60% of total market capitalization on the Nigerian Exchange (NGX, 2023). Most existing studies focus on the financial sector or treat governance and audit mechanisms as independent variables rather than examining their interplay (Uwuigbe, Peter, & Oyeniyi, 2014). This presents a significant gap in the literature.

Consequently, the central problem this study addresses is: *To what extent does CEO share ownership moderate the relationship between audit quality and earnings management in listed non-financial services firms in Nigeria?* The findings are expected to provide relevant insights for regulators, investors, and corporate boards in enhancing governance practices and improving financial reporting quality in emerging markets.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Several empirical studies have examined the relationships among audit quality, CEO share ownership, and earnings management across different contexts. Findings are often mixed, influenced by firm-specific, regulatory, and institutional characteristics, particularly in emerging markets like Nigeria.

Audit Quality and Earnings Management

Audit quality is pivotal in ensuring the integrity of financial reporting and mitigating earnings management. High-quality audits, often associated with reputable audit firms (e.g., Big Four), are expected to detect and deter manipulative accounting practices. DeAngelo (1981) posits that larger audit firms have more to lose from audit failures, thereby providing higher quality audits.

In the Nigerian context, Okonkwo et al. (2022) examined conglomerate companies and found that audit fees had a significant positive effect on earnings management,

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suggesting that higher fees might not always equate to better audit quality. However, the presence of Big Four auditors showed a positive but statistically insignificant effect on earnings management. This indicates that merely engaging reputable audit firms does not automatically constrain earnings manipulation in Nigeria.

Similarly, Okegbe et al. (2023) studied manufacturing firms and observed a non-significant negative effect of audit firm size on accruals quality, implying that larger audit firms might not significantly influence earnings management practices. However, ownership concentration had a significant negative effect on accruals quality, highlighting the interplay between ownership structures and audit effectiveness.

Internationally, Ismael and Kamel (2021) investigated UK companies and found that internal audit quality negatively correlated with abnormal accruals, emphasizing the role of competent internal audit functions in curbing earnings management.

Ajape et al. (2024) examined the connection between audit quality and earnings management practices in listed non-financial firms in Nigeria. Prior work: The study extends the discussion on the earnings management and audit quality nexus by exploring the concept of real earnings. A purposive nonprobability sampling procedure was employed to choose a sample of 30 quoted companies on the Nigerian Exchange Group (NGX). Data was retrieved from the audited financial reports of the selected companies for ten years (2012-2021), and hypotheses were tested using the random effect regression model. Results: The results showed that the audit quality metrics used (audit fee, specialisation of the auditor, auditor's tenure, and audit firm size) could not apprise any significant change in the actual earnings management practice of the sampled firms. Implications: Future researchers should consider different factors and proxies to measure audit quality, which may have significant effects on actual earnings management in Nigeria. Value: The study upsets the preponderant notion of audit quality having a declining effect on earnings management, and in uncovering real earnings management, size, the quantum of audit fees paid, length of the auditor-client relationship, and engagement of industry-specialised auditors offer no robust influence. They look at audit quality and earnings management, but the current study introduces the moderating influence of CEO share ownership.

H_{01}: Audit quality has no significance effect on earnings management of listed non-financial service firms in Nigeria.

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CEO Share Ownership and Earnings Management

CEO share ownership presents a complex relationship with earnings management. Agency theory suggests that when CEOs hold significant equity, their interests align with shareholders, potentially reducing earnings manipulation (Jensen & Meckling, 1976). Conversely, excessive ownership might lead to entrenchment, where powerful CEOs override governance mechanisms to engage in opportunistic behaviors.

In Nigeria, Irom et al. (2023) analyzed manufacturing companies and found that managerial ownership significantly affects real earnings management. However, when moderated by the financial expertise of the audit committee, the effect of ownership structure on real earnings management diminished, indicating that robust internal controls can mitigate potential negative impacts of high managerial ownership.

Globally, studies have shown mixed results. For instance, research in Bangladesh indicated that while some studies found CEO ownership enhances earnings quality, others observed that excessive ownership reduces internal control quality and intensifies earnings fabrication.

Managerial ownership has also received substantial empirical attention. Irom et al. (2023) studied 30 listed manufacturing firms in Nigeria and found that managerial ownership was significantly related to real earnings management, indicating that as CEOs own more shares, they are more likely to engage in operational decisions that manipulate earnings (e.g., overproduction or sales timing).

Meanwhile, Usman and Amran (2015), examining 76 non-financial listed companies in Nigeria from 2008 to 2012, found a negative relationship between CEO ownership and earnings management, supporting the alignment hypothesis. However, they also cautioned that beyond a certain threshold, CEO ownership might lead to entrenchment and reduced transparency.

Globally, studies such as Rahman and Ali (2020) in Malaysia found that moderate levels of CEO ownership reduced earnings manipulation, while excessive ownership increased it, reinforcing the U-shaped relationship proposed by agency theory.

Audit Quality, CEO Ownership, and Earnings Management Interaction

The interaction between audit quality and CEO share ownership significantly influences earnings management practices. High-quality audits can serve as a counterbalance to the potential risks posed by substantial CEO ownership. However, in environments where CEOs possess considerable power, even reputable audits might not suffice to deter earnings manipulation.

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Okegbe et al. (2023) highlighted that the combination of ownership concentration and audit firm size had a significant negative effect on accruals quality, suggesting that concentrated ownership structures might enhance the effectiveness of audits in curbing earnings management.

Furthermore, Obigbemi et al. (2016) emphasized the importance of board structures, noting that duality in CEO and chairman roles can exacerbate earnings management, especially when combined with weak audit functions.

Few studies have examined the moderating role of CEO ownership on the relationship between audit quality and earnings management. Obigbemi et al. (2016), using panel data from Nigerian firms, observed that dual roles of CEO and chairman (a proxy for CEO dominance) weakened the effectiveness of audit committees and external auditors in reducing earnings manipulation.

Furthermore, Okegbe et al. (2023) noted that ownership concentration enhanced the impact of audit quality, implying that in firms with dominant owners, auditors might be more effective due to increased pressure for transparency. However, when the dominant owner is the CEO, this effect could reverse.

This highlights the need to empirically assess how CEO share ownership may moderate the audit quality and earnings management nexus, especially in markets where ownership structures are highly concentrated.

H_{02}: CEO Share ownership has no moderating effect on the relationship between Audit quality and earnings management of listed non-financial service firms in Nigeria.

Agency Theory Review

The present study is anchored on Agency Theory, originally developed by Jensen and Meckling (1976), which explores the relationship between principals (shareholders) and agents (managers or executives) in a corporate setting. The theory postulates that managers, as agents, may not always act in the best interest of shareholders due to conflicts of interest, especially when ownership and control are separated. This divergence often gives rise to agency problems, such as earnings management, as managers may manipulate financial reports to meet performance targets or secure personal benefits (Fama & Jensen, 1983).

In this context, audit quality serves as a monitoring mechanism that helps reduce information asymmetry and deter opportunistic behavior by ensuring that financial statements reflect a true and fair view of the firm's performance (Watts & Zimmerman,

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1986). High-quality audits are expected to curb earnings manipulation and protect shareholders' interests.

However, when a CEO holds a significant portion of company shares, it introduces a dual role as both agent and partial principal. On one hand, this alignment of interests can reduce agency costs, as the CEO is more likely to act in the firm's best interest (Jensen & Meckling, 1976). On the other hand, excessive CEO ownership may lead to managerial entrenchment, where the CEO becomes too powerful and less subject to monitoring mechanisms such as external audits, thus facilitating earnings management (Shleifer & Vishny, 1997).

Therefore, CEO share ownership may moderate the relationship between audit quality and earnings management either reinforcing the audit's monitoring role through interest alignment or weakening it through entrenchment effects. This theoretical lens provides a comprehensive framework for understanding the dynamics among audit quality, CEO ownership, and earnings manipulation in the corporate governance landscape of Nigeria.

METHODOLOGY

This study adopts an ex-post facto and correlational research design, which is appropriate for examining the relationship between audit quality and earnings management, as well as the moderating role of CEO share ownership within Nigeria's listed non-financial services sector. The correlational design allows for the assessment of both the direction and strength of associations among the variables using quantitative, archival data. The population comprises all non-financial services firms listed on the Nigerian Exchange Group (NGX) as of December 31, 2022, excluding financial services firms such as banks and insurance companies due to their distinct regulatory frameworks and financial reporting structures. A purposive sampling technique was applied to select 72 firms that met specific inclusion criteria: availability of consistent annual reports for the study period (2013–2022), non-financial nature of operations, and disclosure of CEO share ownership and audit-related information.

Secondary data were sourced from published annual financial statements of the sampled companies, the NGX website, company websites, and other relevant financial data platforms, including Factbooks and Bloomberg terminals where available. Data extracted included audit quality indicators (proxied by audit fees), CEO share ownership (measured as the percentage of shares held by the CEO), real earnings management (based on the Gilliam, 2021 model), and leverage (control variable, measured as total

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debt to total assets). Panel regression models were employed for data analysis using Stata 17 software. Descriptive statistics and correlation analysis were conducted to examine data characteristics and multicollinearity, respectively. The Hausman specification test guided the choice between fixed and random effects regression models. Moderation analysis was performed through interaction terms between audit quality and CEO share ownership to assess the moderating effect. The regression models were specified to test both the direct and interactive effects of the independent and moderating variables on earnings management.

Model Specification

To examine the direct and moderating effects, the following **panel regression models** will be employed:

Model 1:

$$Earnings\ Management = \beta_0 + \beta_1 AQUA_{it} + \beta_2 LEV_{it} + E_{it}$$

Model 2:

$$Earnings\ Management = \beta_0 + \beta_1 AQUAit + \beta_2 CEOOWNERSHIPit + \beta_3 (AQUA \times CEOOWNERSHIP)_{it} + \beta_4 LEV_{it} + E_{it}$$

Where:

- **Earnings Management** = real earnings management (Gilliam Model)
- **AuditQuality** = audit fee
- **CEOOWNERSHIP** = CEO shareholding percentage
- **Controls** = leverage.
- **ε** = error term

RESULTS AND DISCUSSION

The presentation, analysis, and interpretation of the data are detailed in this section. This part includes testing hypotheses, conducting diagnostic tests, analyzing regression data, and discussing the results. Discover the findings of descriptive statistics in Table 1. It displays the observations together with the mean, standard deviation, minimum, and maximum means.

Table 1 Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
REM	720	-1.90	2.13	-25.17	8.29

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AQUA	720	0.53	0.50	0	1
CEOOWNERSHIP	720	4.97	12.39	0	63.68
LEV	720	59.77	19.89	12.42	96.67

Source: STATA 17 Output

Table 1 displays a cumulative total of 720 observations, derived from the multiplication of the number of firms (72) by the number of years (10). The real earnings management (REM) averages -1.90 with a standard deviation of 2.13, signifying considerable variability in REM, hence validating its designation as the dependent variable in this study. The REM varies from a low of -25.17 to a maximum of 8.29. The average audit quality (AQUA) is 0.53, with a standard deviation of 0.50, indicating low disparities among enterprises. The least reported value for AQUA is 0, while the greatest is 1. Furthermore, CEO share ownership (CEOOWNERSHIP) possesses a mean value of 4.97 and a standard deviation of roughly 12.39. The least value for CEOOWNERSHIP is 0.00, and the maximum is 63.68, reflecting diverse levels of CEO share ownership among the firms. Also, leverage (LEV) has a mean of 59.77 and standard deviation of 19.89 with a minimum of 12.42 and maximum of 96.67.

The results of heteroskedasticity test are contained in Table 3 for the model.

Table 2 ***Cameron & Trivedi's decomposition of IM-test***

Source	chi2	Df	P
Model	9.30	5	0.3176

Source: STATA 17

Table 2 shows that the model's p-value is 0.3176, which is statistically not significant as it falls above the 0.05 threshold. This indicates there is no presence of heteroskedasticity in the data, even with that, we assumed there is a problem of hetero in the model and that necessitating the use of a robust model to ensure reliable estimates. Table 3 shows the results of the multicollinearity test for the model, giving more information about the relationships between the independent variables.

Table 3 Results of Multicollinearity Test

	Mean VIF
Direct Model	1.07

Source: STATA 17

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The results in Table 3 indicate the absence of multicollinearity, as the mean Variance Inflation Factors (VIF) are below the threshold of 3.3 (Gujarati, 2005), confirming that multicollinearity is not a concern in the model. Additionally, Table 4 also presents the results of the Hausman specification test, providing further validation of the model selection.

Table 4 Results of Hausman Specification Test

	Chi^2	p-Value
Direct Model	4.81	0.19

Source: STATA 17

The findings in Table 4 indicate that the suitable analytical method for the model is the Random Effects Model (REM). The Breusch and Pagan Lagrangian Multiplier test for random effects reveals significance, evidenced by a Chi² value of 377.81 and a p-value of 0.000. The regression outcomes for REM in the direct model are displayed in Table 5.

Table 5 ***Results of REM Regression (Without Moderation)***

REM	Coef.	Robust St.Err.	t-val.	p-val.			Sig
AQUA	-0.795	0.162	-4.89	0.000			***
CEOOWNER	0.010	0.007	1.57	0.117			
LEV	0.003	0.018	2.13	0.034			***
Constant	-1.795	0.1822	-9.85	0.000			***
F – Stat 13.55			0.000 ***				
R-squared		0.05					
*** p<.01, ** p<.05, * p<.1							

Source: STATA 17

Similarly, the results of ROA regression for Model 2 are reported in Table 6.

Table 6 Results of REM Regression (With Moderation)

REM	Coef.	Robust St.Err.	t-val.	p-val.			Sig
AQUA	-0909	0.246	-3.79	0.000			***
CEOOWNER	0.010	0.001	14.04	0.000			***

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CEOOWNERAQU	0.001	0.008	0.10	0.924			
LEV	0.004	0.000	39.91	0.000			
Constant	-1.797	0.115	-156.3	0.000			***
F-test	3929.91		Prob > chi2		0.0000 ***		
Source: STATA 14.2							

From Tables 5 and 6, the probability values (prob > chi²) for both models were found to be significant, indicating that the results are statistically reliable for explaining the relationships in the models. Additionally, audit quality is significant in both model whale CEO ownership is not significant in direct model but is significant at moderated model. Furthermore, when CEO share ownership (proxied by percentage of share own by CEO) was introduced as a moderating variable, there was no changes in the coefficient values were observed, confirming no moderating effect.

Thus, the study concludes that CEO ownership, as measured by CEO percentage of share, does not act as a moderating factor for audit quality. Audit Quality exhibited a negative and significant impact on earnings management (measured by real earnings management), with a coefficient value of -0.795 and a p-value of 0.000. Furthermore, CEO ownership had an insignificant effect on real earnings management, with a coefficient value of 0.010 and a p-value of 0.117. The moderated variable also demonstrated an insignificant positive influence on the relationship between audit quality and earnings management.

Accordingly, the study accepts the null hypothesis, which states that CEO share ownership has no significant moderating effect on the relationship between audit quality and earnings management of listed non-financial services firms in Nigeria. Instead, it concludes that audit quality has a negative and significant impact on earnings management. These findings are consistent with prior studies by Ismael and Kamel (2021) and Okonkwo et al. (2022) but contradict the results of Okegbe et al. (2023) and Ajape et al. (2024), who reported an insignificant relationship between audit quality and earnings management and the result is in line with agency theory. Furthermore, the moderating role of CEO share ownership does not reinforce the conclusion that audit quality negatively and significantly influences earnings management in Nigerian non-financial firms.

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CONCLUSION AND RECOMMENDATIONS

This study analyzed the moderating effect of CEO Share ownership on the relationship between audit quality and earnings management of listed non-financial firms in Nigeria. The audit quality is the independent variable, and CEO share ownership is the moderated variable while dependent variable is proxy by real earnings management. The study is conducted from 2013 to 2022. The study, therefore, concludes that CEO share ownership is not a determinant factor in the nexus between audit quality and earnings management. Therefore, the study recommends that the fight against earnings management should focus on improving external audit abilities while implementing strict audit rules as a more effective solution instead of depending on CEO ownership for governance purposes. All companies need to focus on achieving strong auditor quality to boost financial statement confidence across every CEO ownership.

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