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Earnings Management, Audit Quality and Financial Performance of Quoted Petroleum Marketing Industries in Nigeria

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Abstract
This research looks at the effects of revenue management, audit quality on financial performance of publicly listed Nigerian petroleum marketing firms. Data for the years 2010 to 2020 were taken out of the sampled companies' annual reports. Results from the GMM estimator showed that the audit committee's financial expertise and independent auditors have a significant impact on return on assets, and p-values at the 5% level of significance, respectively, while discretionary accrual had an insignificant impact on return on assets. The study concluded that the lack of significance of discretionary accrual in the possibility of receiving a qualified audit report could not indicate that auditors are unaware of earnings management, but rather that they are much more concerned about it when these decisions lead to inflated rather than understated earnings. In order to reduce the detrimental impact of earnings management on the financial performance of listed petroleum marketing businesses in Nigeria, the study advises that suitable mechanisms for the fast detection of earnings management techniques be implemented.
Keywords: Earnings Management, Audit Quality, Financial Performance
JEL Classification Codes: M41, M42, M39

1. Introduction

Financial records are the heart of any business, giving an accurate and timely picture of its financial health to both internal and external constituents. The International Accounting Standards Board (2001) has reaffirmed that financial reports are intended to provide information on a company's financial situation, achievements, and changes in financial circumstances that can help a wide range of users in making financial choices (Sun & Rath, 2008). Earnings data is a potent instrument for investors to examine a company's current performance and make educated forecasts about its future prospects.

Earnings management is a deliberate tactic used by managers to strategically change financial reporting and transaction structuring, with the goal of changing the presentation of financial statements in a way that can mislead certain stakeholders about the true economic performance of the company or affect the outcomes of contracts based on reported accounting figures (Kankanamage & Aruna, 2015). In an effort to maintain their stewardship role, organizations' drivers of economic activity have steered a basic problem by establishing information asymmetry that has encouraged CEOs' dishonest behavior, particularly with regard to the manipulation of accounting information.

The accuracy and integrity of the financial data provided by management in financial statements must be viewed in the context of the quality of an audit in order to give different stakeholders an acceptable degree of trust. Even though there have been attempts to stop profits manipulation due to several corporate financial scams in Nigeria. Cadbury Nigeria Plc., African Petroleum, Lever Brothers Nigeria Plc, and Nampak, have seriously harmed public confidence in audit quality (Odia, 2007; Okolie & Agboma, 2008; Adeyemi & Fagbemi, 2010; Oluwagbuyi & Olowolaju, 2013; Okolie & Izedonmi, 2014). As a consequence, investors and other company financial reporting stakeholders are dissatisfied, which has a negative effect on their economic choices. It's disheartening to see that, despite efforts to ensure openness and truth in financial reporting, some businesses continue to participate in unethical practises that harm stakeholders' interests.

Recently, earnings management has been linked to corporate financial scandals and failures. This situation was seen in the recorded instances of First Bank in 2021, where authorities found over N150 billion in non-performing insider loans and poor credit choices, N75 billions of which belonged to the board chairperson alone. (Emefiele, 2021); Worldcom, Enron, and Xerox, to name a few, and thus calls for tighter regulations on financial reporting (Inaam, Khmoussi & Fatima, 2012; Kankanamage & Aruna, 2015; Zayol, Adzembe & Akaa, 2017).

Studies in the field of earnings management have been carried out in Nigeria, such as Olaniyi and Abubakar (2018), Martinez and Moraes (2016); Ozkan (2018); Ishaku *et al.,* (2019); Junaidu and Ahmed (2020); Zayol, Adzembe and Akaa (2017); Haider (2020) focus on consumer goods, industrial goods, and banking sector while the majority of the studies were conducted outside Nigeria. The few studies that have been conducted in the oil and gas industry have limited their analysis to 2016, and they have also missed certain moderating factors that could have an impact on how effectively Nigerian petroleum marketing companies perform financially. In order to objectively analyze how earning management and audit quality impact the financial performance of listed petroleum marketing businesses in Nigeria

2. Literature Review

2.1 Conceptual Review

2.1.1 Concept of Earnings Management

There is not a consensus meaning of "earnings management" in the accounting journals just yet. Earnings management is the practise of modifying financial outcomes using bookkeeping procedures and strategies. The phrases "creative accounting," "revenue smoothing," and "the accounting numbers game" are frequently used equally to refer to this concept (Balaciu, Bogdan & Vladu, 2009; Mulford & Comiskey, 2002). According to how they view it, different scholars have different methods of explaining the concept of earnings management. Earnings management, according to Healy and Wahlen (1999), is the process of altering financial accounts by using judgement in financial reporting and arranging transactions accordingly. One of two reasons for doing so is to either affect the terms of contracts whose terms rely on the accounting numbers stated on them or to mislead some stakeholders about the company's real financial success. Earnings management is divided into two categories: actual manipulation of real business activities and accrual management utilizing accrual accounting. Earnings management can be carried out in a variety of methods in an organization.

Accruals Management: The accrual concept, a crucial accounting principle, instructs businesses to document income and expense items when the benefit is realised rather than when the money is paid or received. This is one of the widely acknowledged accounting principles that managers can employ to boost or lower the company's economic performance (Dechow & Skinner, 2000). Accrual management does not include altering the fundamental operations of commercial organizations; rather, it entails selecting the accounting techniques to be applied to various activities carried out by the organization. Therefore, accrual accounting gives managers of the company significant control over determining the firm's profits over various time periods. Additionally, managers have choices for recognising revenues, such as an early acknowledgment of revenue through credit purchases, which together with other methods can be used to manipulate the earnings to the manager's requirements (Junaidu & Ahmed, 2020).

Real activity Management: Changing all or a part of a company's operational procedures in an attempt to boost current-period profits is known as this practise. Real activity management in an organisation can take many different forms, including increasing output or overproducing to lower cost of goods sold or lowering some desirable costs, like research and development funding, in order to boost present revenues. Real activity management, as defined by Schipper (1989), takes place when the company's managers take deliberate steps to alter the timing or structuring of operations, investments, or financial activities that have the potential to impact the financial statements' stated figures

2.1.2 Concept of Audit Quality

International Auditing and Assurance Standards Board [IAASB], (2011) claimed that the term audit quality has been defined numerous times in the past. None, however, has led to a definition that has attained wide acceptance and recognition. Fundamentally, audit quality is a complicated and multifaceted idea. DeAngelo (1981) gave the accepted meaning of audit quality, according to Osisioma, Okoye, Ezejiofor and Okoye (2020), which is the combined likelihood that a particular auditor will both (a) find and (b) reveal a defect in the client's accounting system. The definition gives significant weight to two key components of audit quality: the professionalism of the audit firm, which determines the probability that a false representation will be found, and the auditor's objectivity and independence, which determines what the auditor is probable to do in response to an identified misrepresentation.

The quality of research assessments has greatly benefited from this criterion. According to DeAngelo's (1981) definition, the auditor's tendency to find and honestly report major errors, misrepresentations, or omissions in the client's financial records is the essence of audit quality. In contrast to Wallace (1987), who sees audit quality as a measure of the auditor's ability to reduce noise and prejudice and meticulously enhance accounting data, Davidson, Stening and Wai (1984) merely assert that audit quality is the precision of the auditor's information reporting. According to Davidson and Neu (1993), the idea of audit quality is founded on the auditor's ability to recognise and correct significant misstatements and manipulations of stated net income.

According to Khan (2006), the degree of direct audit participation and the criteria used to judge the audit's substance determine the audit quality among stakeholders.. Audit quality can be regarded from three primary perspectives: inputs, outcomes, and background factors. The qualities of the auditor, such as their mindset, ethical standards, and degree of expertise, are additional variables that influence audit quality in addition to auditing criteria. A high-quality audit is made possible by the audit process, which includes the validity of the audit methodology, the efficiency of the audit instruments used, and the availability of suitable technical help. Stakeholders evaluate the audit's quality by taking into account the findings, which have a significant impact on the audit's quality.

2.1.3 Audit Committee Financial Expertise and Return on Assets

First acknowledged under Sections 359 (3) and (4) of the CAMA, the problem of financial competence for at least one audit committee member. In the SEC code of 2011, this was reiterated once more. The literature also backs up this claim. Having a member of the audit committee who is knowledgeable about finances, according to Carcello and Neal (2000), would probably result in less earnings management for companies with lax corporate governance systems. Similarly, Qin (2007) discovered that organisations with greater earning quality are more likely to have audit committee members with financial experience. More recent studies have supported this claim as well. According to Bouaziz and Triki (2012), "returns on equity and return on asset have a significant impact on audit committee financial expertise." According to the aforementioned data, a favourable correlation between the audit committee's financial knowledge and the company's financial success is predicted.

2.1.4 Auditor Independence and Return on Assets

Recently, Hamdan *et al.,* (2013) looked at the performance of the Amman stock exchange businesses in connection to the independence of the audit board. The audit committee's independence improves the effectiveness of the business. In a sample of Tunisia-listed companies from 2007 to 2010, Bouaziz and Triki (2012) found that the audit committee's position had an impact on the performance of the ROA and ROE performance proxies.The relationship between the success of enterprises and the audit committee's independence has been demonstrated. According to Al-Matari, Al-Swidi and Fadzil (2014), Oman's financial outcomes and audit committee independence have both noticeably improved. On the other hand, according to Bansal and Sharma (2016), there is no correlation between the financial performance of Indian corporations and the audit committee's independence. Contrarily, there are unfavourable correlations between independent audit committee performance and corporate performance, according to Robin and Amran (2016) research. Between 2010 and 2014, the study was done on 122 family-owned listed firms on the Indonesia Stock Exchange. Dar *et al.,* (2011) from Pakistan likewise have a negative correlation. In Kenya, Wakaba (2014) discovered a bad association between the audit committee's performance and that of the firm.

2.2 Empirical Review

Olaniyi and Abubakar (2018) investigated the effect of real earnings management on the financial performance of listed consumer goods companies from 2001 to 2016. A research design known as ex-post facto was used, which heavily relied on secondary data taken from the 22 public businesses' audited financial accounts. A panel generalised technique of moments was used to investigate the effects of control factors, ROE and EPS (financial success), and sales modification (earnings management) (firm size, growth, and financial strength). According to the study, consumer products firms in Nigeria with stock quotes manipulate their sales to boost their earnings.

Okoro and Ihenyen (2020) investigated how sub-Saharan African enterprises' returns on assets and equity were affected by pressure from earnings management. By using the fixed and random effects statistical approach, the data were gathered from the Sub-Saharan African Stock Exchange database. Despite the fact that earnings management places a lot of pressure on firms' performances, the study uses the proposed earnings management model to produce some intriguing results that could advance knowledge and the body of literature. According to the study, a firm's size significantly influences how the relationship between earnings management and performance of Sub-Saharan African enterprises is moderated.

Haider (2020) researched the driving forces behind the abuse of earnings. The motivations behind earning manipulation are thought to be firm size, profitability, financial leverage, and effective tax rate. The study was conducted on Pakistan's banking industry. The study discovered that anytime a company's profit declines, the managers may use the future expected earnings in the current year to maintain the company's favorable reputation. Using debt to finance the firm's capital will also cause the managers to omit reporting the incorrect data. The tax rate and firm size were shown to be negatively but insignificantly related to the management of earnings.

In their study, Sunday, Akabom and Ejabu (2020) investigated how management-created accruals may impact manufacturing companies' ability to continue operating. Data were acquired utilizing the retrieval method and the expo-facto research design. A panel regression model merged the features of cross-sectional data and time series. According to the study's empirical findings, discretionary accruals had a substantial impact on the companies it analyzed in terms of their liquidity positions and profitability levels, which has an impact on their capacity to continue operating as a going concern.

Amahalu and Obi (2020) conducted study on how the quality of the audit impacted the financial performance of Nigerian listed conglomerates. The annual reports and accounts of six (6) sampled quoted conglomerates for the years 2010 to 2019 were utilised to generate the panel data that was used in this study. Research methodology known as ex-post facto was used. Inferential statistics were used to assess the study's hypotheses, and the Pearson correlation coefficient and Panel least square regression analysis were both employed. The findings indicated that, at the 5% level of significance, the audit committee's size, independence, and financial knowledge all significantly positively affect return on assets.

Azam and Wang (2021) examined how the value of Palestinian enterprises was impacted by the audit committee's characteristics. The study examines the effectiveness of the Audit Committee's features, namely independence and expertise, by assessing the correlation between the dependent and independent variables. From 2011 through 2018, a list of businesses listed at the Palestine Stock Exchange provided secondary data that was gathered. The audit committee's independence and skill are evaluated as individual variables, and the ROA is used as the dependent variable as a measure of a firm's worth. The findings demonstrated that the independence and skill of the audit committee had a significant beneficial impact on ROA.

3. Methodology

Ex-post factor research is the study's chosen design. As of December 31, 2020, there were fourteen (14) petroleum marketing companies traded on the Nigeria Group Exchange (NGX), which makes up the study's target group. For the research, Seplat Petroleum Development Company Plc is not included in the sample size of thirteen (13) petroleum marketing firms registered on the floor of the Nigerian Group Exchange because of its incomplete data in the periods of study. The annual reports of the sampled firms were mined for secondary data covering the years 2010 through 2020. To handle heteroskedasticity, unobserved heterogeneity, and endogeneity, the research employs the Generalized Method of Moments (GMM) estimator. When independent factors and error terms are correlated, this is known as endogeneity. Due to its superior ability to deal with endogeneity, this research employs the GMM estimator (Wintoki, Linck & Netter, 2012).

This study adapted the model of Okoro and Ihenyen (2020) which was stated thus:

$ROA = \alpha + \beta 1EMT + \beta 2FSIZE + \beta 3EBIT + \beta 4NPAT + \varepsilon$ - (1)

This study then modified the model of Okoro and Ihenyen (2020) and stated as follows:

$ROA = f(DESAC, ACFE, AUDIN) ------------- (2)$

$ROAit = \alpha + \beta 1DESACit + \beta 2ACFEit + \beta 3AUDINit + \mu i ---- -(3)$

$Where$:

$ROA = Return\ on\ Asset$

$DESAC = Discretionary\ Accrual$

$ACFE = Audit\ Committee\ Financial\ Expertise$

$AUDIN = Auditor\ Independent$

$\alpha = Intercept$

$\beta 1 - \beta 3 = Estimation\ parameters$

$\mu it = \varepsilon it + \lambda i$;

$\varepsilon it = stochastic\ error\ term$;

$\lambda i = unique\ variation\ in\ cross - sections\ (Composite\ Error)$

$A\ priori\ expectation\ is\ that\ \beta 1 - \beta 3 > 0$

4. Results and Discussion

Table 1: Results of Pairwise Correlation Analysis

	ROA	DESAC	ACFE	AUDIN
ROA	1			
DESAC	-0.013	1		
	(0.882)			
ACFE	0.0507	-0.1904	1	
	(0.563)	(0.028)		
AUDIN	0.0647	0.2906	0.008	1
	(0.460)	(0.000)	(0.927)	

Note: ROA is return on assets; DESAC is discretionary accrual; ACFE is audit committee financial expertise; and AUDIN is audit independence.
Source: Author's Computations, 2022.

None of the correlation coefficients for the relationships between the explanatory factors are higher than 0.8, according to the correlation analysis findings shown in Table 1. Following the rule of thumb of detecting severe multicollinearity (Asteriou & Hall, 2006), this signifies that employing these variables together in a regression model would not lead to the problem of severe multicollinearity. The findings of the inferential analysis of variables are the central subject of this part. Regression analysis is used as the primary inferential analysis method to investigate the impacts of audit quality and earnings management on the financial performance of openly traded Nigerian petroleum marketing firms. The outcomes are shown in accordance with what the system generalises method of minute (GMM) predictor has found. An evaluation of each variable's stationarity using a unit root test was done before the calculation.

Table 2: Results of Fisher-type Augmented Dickey-Fuller Unit Root Test

Variable	P-statistic	p-value	Z-statistic	p-value	L*-statistic	p-value	Pm-statistic	p-value	Remark
ROA	127.2	0.000	-5.217	0.000	-9.073	0.000	14.90	0.000	Stationary
DESAC	74.32	0.000	-3.145	0.000	-4.765	0.000	7.264	0.000	Stationary
ACFE	25.47	0.380	-2.105	0.017	-2.426	0.010	0.212	0.145	Stationary
AUDIN	109.3	0.000	-3.389	0.000	-7.063	0.000	12.32	0.000	Stationary

Note: P-statistic is negative chi-squared measure; Z-statistic is negative normal statistic; L*-statistic is Inverse logit t statistic; Pm-statistic is Modified inverse chi-squared statistic. ROA is return on assets; DESAC is discretionary accrual; ACFE is audit committee financial expertise; and AUDIN is audit independence.
Source: Author’s Computations, 2022.

The results of the Fisher-type enhanced Dickey-Fuller method were used to generate the unit root test findings shown in Table 2. The test reveals four test statistics for the test which include the inverse chi-squared statistic (P), inverse normal statistic (Z), inverse logit t statistic (L*) and modified inverse chi-squared statistic (Pm). The test results revealed that the four test statistics support the fact that each ROA, DESAC and AUDIN is stationary. Looking at the findings, it is clear that all test statistics have high statistic values and low p-values, which are sufficient to deny the test nu1l hypothesis of the existence of a unit root, or in other words, non-stationarity. It is then concluded that the variable is stationary. Given that the estimation technique employed in this study is the system GMM, the stationary and non-stationary series can be employed in a model without any consequence of having spurious result.

Table 3: Result of Variance Inflation Factor (VIF) for Return on Assets Model

Variable	VIF	1/VIF
AUDIN	3.31	0.301964
DESAC	3.28	0.304575
ACFE	2.39	0.417846
Mean VIF	3.27	

Source: Author’s Computations, 2022.

Table 3 in this study displays the VIF result of the return on assets model. The model used in this research is clear of multi-collinearity issues because all of the VIF values were less than 10. The numbers for the tolerance (1/VIF) also point to a similar inference because they are all significantly higher than zero. The variance inflation factor results therefore revealed that all the independent variables of the model do not exhibit very high correlation that can lead to multi-collinearity problem. The outcome strengthens the judgement made based on the pairwise correlation analysis.

Table 4: Result of System GMM for Return on Assets

Variable	Coefficient	Standard Error	Z	p-value
ROA(lag)	-0.18207	0.078181	-2.33	0.02
DESAC	0.000808	0.003486	0.23	0.817
ACFE	0.117613	0.146405	0.8	0.004
AUDIN	-0.07198	0.043454	-1.66	0.002
Constant	1.587363	0.827331	1.92	0.055
Sargan test	6.671			0.891
AR test (1)	-1.559			0.119
AR test (2)	-1.311			0.189

Note: ROA is return on assets; DESAC is discretionary accrual; ACFE is audit committee financial expertise; AUDIN is audit independence; and BS is board size. AR is autocorrelation test.
Source: Author's Computations, 2022.

Evaluating the model of this study in terms of autocorrelation (or serial correlation), the result presents the Arellano-Bond test of autocorrelation (AR), which has null hypothesis of no autocorrelation. The basic assumption of the test is that first-order autocorrelation may be permissible in the GMM result, however, second-order autocorrelation raises serious concern about the validity of the result. The result shows that the first-order autocorrelation statistic value is very high (-1.559) and the p-value is well over 0.005. This indicates that the test's null hypothesis of no first-order autocorrelation could not be rejected, which satisfy the test's condition and suggest that the model lacks first-order correlations. The result also shows that the second-order autocorrelation statistic value is very high (-1.311) and the p-value is well over 0.05. This indicates that the test null hypothesis cannot be rejected at the second-order tests, which satisfy the test's condition. Therefore, the model is free from autocorrelation problems, both at first order and second order tests.

The Sargan test of over-identifying restriction was used to evaluate the veracity of the tools used to create this model. This was done to check the validity of the limitations imposed on the tools used to prevent over-identification. This test's null premise is that over-identifying limitations are legitimate. The findings indicate that the test's null hypothesis could not be denied for the model, given that the statistic value of this test result is 6.67 and its p-value is higher than 0.01. This suggests that the model can accommodate the over-identifying limitation.

When each explanatory variable in the model was examined for significance, the findings revealed that audit independence has negative correlations (-0.07198) and a p-value (0.002). The audit independence has a small but substantial negative impact on return on assets, whereas the audit committee's financial competence and discretionary accrual have positive coefficients (0.000808 and 0.1176, respectively, with p-values of 0.004). This indicates that audit committee financial competence and audit autonomous have positive and statistically significant effects on return on assets at the 5% level of significance, whereas discretionary accrual has a positive but negligible impact on return on assets.

In accordance with the significant negative coefficient of lag of return on asset, an increase in first year period lag of return on asset will cause a decrease in current return on assets of 0.18207 percent points. Audit committee financial expertise, auditors independent, have statistically significant as it can be verified by their respective p-value of less than 0.05 significance level. Discretionary accrual is insignificant with their p-value greater than 0.05 significance level.

4.1 Discussion of Findings

The generalised moment method was applied to analyse the effects of earnings management on the financial performance of Nigeria's traded petroleum marketing companies. The main conclusions of this research demonstrate that the financial competence of the audit committee and the impartiality of the accountants showed a positive and substantial impact of earnings management on the financial performance of listed petroleum marketing firms in Nigeria. In particular, the GMM regression analysis showed that the financial competence of the audit committee and the impartiality of the accountants have a favourable and statistically significant impact on the financial success of Nigerian petroleum marketing firms as measured by return on assets. This is in line with the studies of Amahalu and Obi (2020) and Azam and Wang (2021).

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5. Conclusion and Recommendations

According to findings, earnings management significantly contributes to the decline in the financial success of gasoline marketing businesses. It has depicted the company's image unethically, despite the fact that there has been no legal infraction. The particular finding of this study is that independent auditors and the financial skills of the audit committee have a statistically significant impact on the return on assets of Nigerian petroleum marketing firms. But for the selected businesses, discretionary accrual has little impact. Following suggestions were made regarding the administration of earnings and the effectiveness of petroleum marketing firms in Nigeria based on the findings from study.

i. Appropriate and proper measures should be put in place for adequate evaluation and scrutinisation of quoted petroleum marketing companies financial statements in Nigeria and adequate procedures for quick detection of earnings management practices should also be put in place to mitigate the negative effect of earnings management on financial performance of quoted petroleum marketing companies in Nigeria.

ii. Audit committee financial expertise membership of quoted petroleum marketing companies should contain not less than 70% member with accounting and finance background and knowledge, and this should be strictly enforced by the quoted petroleum marketing companies in Nigeria. This is in view of the fact that audit committee financial expertise will improves the effectiveness of firms' specialist auditors in mitigating earnings management of firms through their interaction.

iii. Independent auditors are crucial in assessing management and making sure that goals are being pursued in a way that serves shareholders' interests. Independent auditors have a big influence on how listed petroleum marketing businesses manage their earnings reduction. The management of petroleum marketing firms that are publicly traded should make sure that shareholders' interests are protected and that financial reporting is transparent.

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