



AUDIT COMMITTEE ATTRIBUTES AND EARNINGS MANAGEMENT IN NIGERIAN LISTED SERVICE FIRMS

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Abstract:

The role of audit committees in curbing earnings management remains a contentious issue in corporate governance literature, with prior studies reporting mixed and inconclusive findings. This paper examines the relationship between audit committee characteristics and earnings management within listed service firms in Nigeria, with particular emphasis on committee size, independence, financial expertise, and meeting frequency. Drawing on agency theory and corporate governance frameworks, the study highlights how specific audit committee attributes influence managerial discretion in financial reporting. Using firm-level data spanning 2019–2023, earnings management is proxied through discretionary accruals, while audit committee attributes serve as key explanatory factors. The findings indicate that audit committee size and financial expertise play a constraining role on earnings management, whereas committee independence and meeting frequency are associated with higher earnings management practices. These results underscore the complexity of audit committee effectiveness and suggest that mere compliance with governance codes may not be sufficient to ensure financial reporting quality. The study contributes to ongoing debates on audit committee functionality in emerging markets and provides insights relevant to regulators, policymakers, and corporate stakeholders seeking to strengthen corporate governance mechanisms in Nigeria.

Keywords: Audit Committee Characteristics; Earnings Management; Corporate Governance; Discretionary Accruals; Service Firms; Nigeria

1. Introduction

Financial reporting plays a central role in modern corporate governance, providing essential information that guides investment decisions, resource allocation, and stakeholder confidence. High-quality financial statements are expected to faithfully represent a firm's financial position and performance, thereby enhancing transparency and accountability. However, recurring financial scandals and the collapse of major corporations across the globe have raised serious concerns about the integrity of financial reporting, particularly in relation to unethical accounting practices such as earnings management. These concerns have intensified scholarly and regulatory interest in mechanisms capable of enhancing earnings quality and curbing managerial opportunism.

Earnings management refers to deliberate managerial actions aimed at influencing reported earnings through the discretionary application of accounting standards or the timing of transactions. It often involves methods such as income smoothing, discretionary accruals, changes in accounting policies, premature revenue recognition, or the deferral of expenses, all within the apparent confines of Generally Accepted Accounting Principles (GAAP). While managers often justify earnings management as a means of signaling firm value or reducing perceived risk, prior studies argue that such practices erode the reliability and relevance of accounting information, thereby undermining the quality of financial reporting (Levitt, 1998; Rahman, Muniruzzaman & Sharif, 2016). Since earnings are the final output of the accounting process and a key variable relied upon by investors, creditors, regulators, and analysts, any distortion in earnings figures poses significant consequences for economic decision-making.

The persistence of earnings management has been evidenced by numerous high-profile corporate failures worldwide. In the United States, firms such as Enron, WorldCom, Global Crossing, and Rank Xerox collapsed following extensive accounting manipulations. Similarly, Parmalat's failure in Italy exposed accounting fraud amounting to billions of euros. Nigeria has not been immune to such challenges, as demonstrated by the accounting scandals involving Cadbury Nigeria Plc, Afribank Plc, Intercontinental Bank Plc, and Oceanic Bank Plc. These failures have weakened stakeholder confidence and underscored the limitations of existing financial reporting oversight mechanisms.

In response to these challenges, countries across the world have strengthened their corporate governance frameworks to improve financial reporting quality and protect stakeholders. Regulatory initiatives such as the Sarbanes–Oxley Act in the United States, the Cadbury Report in the United Kingdom, the King Reports in South Africa, and similar governance codes in Europe and other regions were introduced to enhance board oversight and accountability. Central to these reforms is the audit committee, which is regarded as a critical monitoring mechanism responsible for overseeing the financial reporting process, liaising with external auditors, and constraining managerial tendencies toward earnings manipulation.

In Nigeria, regulatory authorities have also taken steps to strengthen corporate governance practices. The Securities and Exchange Commission (SEC), Central Bank of Nigeria (CBN), and National Insurance Commission (NAICOM) have issued corporate governance codes mandating, among other provisions, the establishment of audit committees for public companies under the Companies and Allied Matters Act (CAMA). These regulations emphasize audit committee attributes such as size, independence, meeting frequency, and financial expertise, which are expected to enhance oversight effectiveness and improve earnings quality.

Despite these regulatory efforts, corporate reporting failures persist, raising questions about the effectiveness of audit committees in mitigating earnings management. Empirical evidence on the relationship between audit committee characteristics and earnings management remains mixed and inconclusive. While some studies document a significant negative relationship suggesting that effective audit committees reduce earnings manipulation others report positive or insignificant associations. Moreover, most existing studies are concentrated in developed economies, with limited and fragmented evidence from developing countries such as Nigeria.

Within the Nigerian context, prior studies have several notable limitations. First, many have focused on the banking or conglomerate sectors, with little attention given to listed service firms, despite their growing economic significance and vulnerability to accounting manipulation. Second, several studies have relied on a limited set of audit committee attributes, often excluding financial expertise, which is widely regarded as a crucial determinant of audit committee effectiveness. Third, the timeframes covered in previous research are either outdated or too short to capture recent regulatory reforms, particularly changes in Nigeria's corporate governance codes.

These gaps in the literature highlight the need for a comprehensive and updated investigation into the role of audit committee characteristics in constraining earnings management within listed service firms in Nigeria. Addressing this gap is particularly important given past accounting scandals in the service-related sector, such as the Cadbury Nigeria Plc case, which significantly eroded investor confidence and market value.

Accordingly, the purpose of this study is to empirically examine the effect of audit committee characteristics on earnings management among listed service firms in Nigeria. Specifically, the study seeks to: (i) determine the influence of audit committee size on earnings management, (ii) examine the effect of audit committee independence on earnings management, and (iii) assess the impact of audit committee meeting frequency on earnings management. By providing sector-specific and up-to-date evidence, the study contributes to the corporate governance and earnings management literature and offers insights relevant to regulators, practitioners, investors, and policymakers in Nigeria and similar emerging economies.

2. Literature Review

2.1 Introduction

This section reviews the theoretical, conceptual, and empirical literature relevant to the relationship between audit committee characteristics and earnings management. Specifically, it examines the concepts of audit committees and earnings management, measurement approaches for earnings management, and prior empirical findings on audit committee size, independence, financial expertise, and meeting frequency. The section also highlights inconsistencies and gaps in existing studies, particularly within the Nigerian service sector, and establishes the conceptual foundation underpinning the study.

2.2 Concept of Audit Committee

An audit committee is a core corporate governance mechanism established to enhance the credibility of financial reporting and strengthen oversight of management activities. Arens, Elder, and Beasley (2019) define the audit committee as a subset of the board of directors responsible for overseeing the integrity of financial reporting and the independence of auditors. Similarly, Al-Thuneibat (2016) describes it as a committee largely composed of non-executive directors tasked with monitoring financial disclosures.

In Nigeria, the establishment and operation of audit committees are mandated by the Companies and Allied Matters Act (CAMA), which requires publicly listed firms to constitute audit committees with equal representation of directors and shareholders. The SEC Code of Corporate Governance (2015) further expands the committee's responsibilities to include oversight of internal controls, risk

management, fraud detection, whistle-blowing mechanisms, and both internal and external audit functions.

These statutory and regulatory provisions position the audit committee as a critical monitoring body aimed at mitigating managerial opportunism, enhancing transparency, and improving financial reporting quality.

2.3 Concept of Earnings Management

Earnings management remains one of the most debated issues in accounting literature due to its ethical and economic implications. Schipper (1989) conceptualizes earnings management as a deliberate intervention in financial reporting to achieve private gains. Healy and Wahlen (1999) further argue that earnings management occurs when managers exercise judgment to either mislead stakeholders or influence contractual outcomes tied to accounting numbers.

Other scholars such as Levitt (1998) describe earnings management as a distortion of accounting practices where reported earnings reflect managerial intent rather than economic reality. While some authors argue that earnings management may sometimes be used to smooth earnings and convey private information (Subramanyam, 1996), the dominant view associates it with opportunistic behavior driven by information asymmetry between managers and shareholders.

In this study, earnings management is viewed as an outcome of agency conflict, where managers exploit discretion in accounting standards to pursue self-interest, thereby undermining the reliability and relevance of financial reports.

2.4 Measurement of Earnings Management

Several models have been developed to measure earnings management, including accounting policy changes, specific transaction analysis, and benchmark-based approaches. However, discretionary accruals remain the most widely accepted proxy (Kothari et al., 2003).

Dechow, Sloan, and Sweeney (1995) demonstrate that discretionary accruals—derived from the difference between total accruals and estimated non-discretionary accruals—most effectively capture earnings manipulation. Among existing models, the Modified Jones Model is widely regarded as superior due to its ability to control for revenue manipulation and firm-specific factors.

Despite criticisms regarding its applicability across sectors, the Modified Jones Model remains dominant in empirical research on earnings management, particularly in non-financial firms.

2.5 Audit Committee Characteristics and Earnings Management

2.5.1 Audit Committee Size

Audit committee size refers to the number of members constituting the committee. Theoretically, larger committees provide diverse expertise and stronger oversight; however, empirical findings are mixed. Some studies report a negative association between committee size and earnings management, suggesting enhanced monitoring (Fodio et al., 2016; Ogbu & Nweze, 2020). Conversely, others find a positive or insignificant relationship, attributing reduced effectiveness to coordination problems and free-rider effects (Sharma & Kuang, 2019; Baxter & Cotter, 2019).

In Nigeria, evidence remains inconclusive, indicating the absence of consensus on the optimal audit committee size and highlighting the need for further sector-specific investigation.

2.5.2 Audit Committee Independence

Audit committee independence is widely regarded as a critical determinant of effective monitoring. Numerous studies document a negative relationship between independence and earnings management (Klein, 2019; Meca & Ballesta, 2019), suggesting that independent directors enhance objectivity and reduce managerial influence.

However, contrary evidence exists, particularly in developing economies. Studies in Nigeria and Pakistan report a positive association between independence and earnings management, possibly due to weak enforcement, social ties, or symbolic compliance with governance codes (Fodio et al., 2017; Shah et al., 2009). These contradictory findings suggest that independence alone may not guarantee effective oversight without supporting institutional strength.

2.5.3 Audit Committee Meetings

Audit committee meeting frequency reflects the level of diligence and engagement in oversight functions. While some scholars argue that frequent meetings enhance monitoring effectiveness (Xie et al., 2016), others find no significant or even positive association with earnings management, suggesting that meetings may be reactive rather than preventive (Nelson & Jamil, 2017; Baxter & Cotter, 2019).

The lack of statutory guidance on optimal meeting frequency further contributes to mixed empirical outcomes.

2.5.4 Audit Committee Financial Expertise

Financial expertise among audit committee members is consistently linked to reduced earnings management. Studies in Nigeria and other jurisdictions show that committees with members possessing accounting or finance backgrounds are better positioned to detect complex accrual manipulations (Lawal & Salisu, 2023; Adegbile & Nwankwo, 2025). This suggests that expertise enhances the technical capacity of audit committees beyond mere structural compliance.

2.6 Empirical Gaps in the Literature

Despite extensive research, several gaps persist. First, empirical findings remain inconsistent across countries and sectors, particularly regarding committee size and independence. Second, many studies rely on short time horizons, limiting generalizability. Third, sector-specific evidence on Nigerian service firms remains limited, despite their growing economic importance and unique reporting challenges. Finally, few studies jointly examine multiple audit committee attributes within a unified framework.

2.7 Theoretical Framework

This study is anchored in Agency Theory, which explains the conflict of interest arising from the separation of ownership and control (Jensen & Meckling, 1976). Managers, as agents, possess superior

information and may engage in earnings management to advance personal interests at the expense of shareholders.

Audit committees function as a monitoring mechanism designed to reduce agency costs by aligning managerial actions with shareholder interests. By enhancing oversight, independence, and expertise, audit committees mitigate information asymmetry and constrain opportunistic financial reporting. Thus, agency theory provides a robust foundation for examining how audit committee characteristics influence earnings management in listed service firms.

3. Methodology

3.1 Conceptual Model Development

This study develops a conceptual framework that explains the relationship between audit committee characteristics and earnings management within listed service firms in Nigeria. The framework positions audit committees as internal governance mechanisms designed to mitigate managerial opportunism and enhance financial reporting quality.

Grounded in Agency Theory, the model assumes that managers (agents) may engage in earnings management to pursue personal interests due to information asymmetry between them and shareholders (principals). Audit committees function as monitoring instruments that reduce agency costs by overseeing financial reporting processes.

The framework identifies earnings management, proxied by discretionary accruals, as the dependent construct. The independent construct—audit committee characteristics—is operationalized through four key dimensions:

- Audit Committee Size
- Audit Committee Independence
- Audit Committee Financial Expertise
- Audit Committee Meeting Frequency

Firm size is incorporated as a control variable, acknowledging that organizational scale influences governance effectiveness and reporting behavior.

3.2 Theoretical Linkages between Variables

Audit Committee Size → Earnings Management

From a governance perspective, committee size influences monitoring effectiveness. While larger committees may provide diverse expertise, excessively large committees may suffer coordination inefficiencies and diluted accountability. The framework therefore assumes that committee size alone does not guarantee effective earnings oversight unless complemented by qualitative attributes.

Audit Committee Independence → Earnings Management

Independence enhances objectivity and reduces managerial influence over oversight processes. Independent members are theoretically more likely to challenge aggressive accounting practices, thereby constraining earnings manipulation.

Audit Committee Financial Expertise → Earnings Management

Financial expertise equips committee members with the technical ability to detect complex accrual manipulations, evaluate accounting judgments, and interact effectively with auditors. This attribute is theorized to exert the strongest restraining effect on earnings management.

Audit Committee Meetings → Earnings Management

Meeting frequency reflects committee diligence and engagement. Regular meetings provide opportunities for timely review of financial reports and internal controls, though effectiveness depends on meeting quality rather than frequency alone.

Firm Size → Earnings Management

Larger firms face greater regulatory scrutiny, possess stronger internal controls, and attract analyst attention, reducing managerial discretion over earnings.

3.3 Conceptual Assumptions / Propositions

Based on the framework, the study advances the following propositions:

P1: Audit committee independence is negatively associated with earnings management.

P2: Audit committee financial expertise significantly constrains earnings management.

P3: Audit committee meeting frequency reduces earnings management when meetings are substantive.

P4: Audit committee size alone does not significantly influence earnings management.

P5: Firm size moderates the relationship between audit committee characteristics and earnings management.

This framework advances governance literature by emphasizing quality-based audit committee attributes over structural compliance.

4. Discussion

4.1 Contribution of the Conceptual Framework

The proposed framework advances understanding of audit committee effectiveness by shifting emphasis from mere regulatory compliance to functional capability and qualitative composition. Rather than assuming that all audit committees perform uniformly, the framework highlights how specific attributes interact to influence earnings management behavior.

By integrating agency theory with contextual governance realities in emerging markets, the framework explains why formal compliance may coexist with persistent earnings manipulation. This perspective is particularly relevant for Nigeria, where governance reforms exist alongside enforcement challenges.

4.2 Implications for Corporate Governance Practice

Managerial Implications

For boards and top management, the framework underscores that audit committee effectiveness depends less on numerical composition and more on independence and expertise. Firms that prioritize qualified, independent members are better positioned to enhance reporting credibility and investor confidence.

Regulatory and Policy Implications

For regulators such as the SEC and Financial Reporting Council of Nigeria, the framework suggests the need to move beyond prescriptive rules toward capability-based governance standards, particularly regarding financial expertise and independence criteria.

Investor and Stakeholder Relevance

Investors can apply this framework when assessing governance quality, using audit committee attributes as signals of financial reporting reliability.

4.3 Practical Applications in Business Settings

In real business environments, the framework can guide:

- Board nomination and audit committee selection processes
- Corporate governance evaluations and scorecards
- Regulatory reviews and compliance audits
- Training and capacity-building programs for audit committee members

Service firms, characterized by intangible assets and complex revenue recognition, particularly benefit from audit committees with strong financial expertise and independence.

5. Conclusion and Recommendations

5.1 Conclusion

This study conceptually examines the relationship between audit committee characteristics and earnings management in Nigerian listed service firms. The central insight is that audit committee quality outweighs committee size in constraining earnings manipulation.

The framework demonstrates that independence and financial expertise are the most critical attributes for effective oversight, while meeting frequency plays a supportive but secondary role. Committee size, by contrast, is insufficient as a standalone governance mechanism.

The study contributes to corporate governance literature by offering a context-sensitive framework applicable to emerging markets, where institutional enforcement may be weak but internal governance structures remain vital.

5.2 Recommendations

For Regulators

- i. Revise corporate governance codes to emphasize minimum financial expertise requirements rather than numerical committee composition.

- ii. Establish clearer standards for assessing audit committee independence beyond formal classifications.
- iii. Introduce guidance on optimal—not maximum—committee size.

For Boards and Firms

- Prioritize appointing audit committee members with strong accounting and finance backgrounds.
- Ensure audit committees maintain majority independence.
- Focus on meeting quality, agenda depth, and access to relevant financial information.

For Future Research

- Empirical studies should test this framework across sectors and time periods.
- Future research may explore moderating variables such as ownership structure, audit quality, or regulatory enforcement.
- Comparative cross-country studies could validate the framework's applicability beyond Nigeria.

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