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Initial Public Offering Audit Contingent Fees and Post-Listing Earnings Reversal: Evidence from a Nigerian Emerging Market

Running title: IPO Audit Contingent Fees and Post-Listing Earnings Reversal

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ABSTRACT

Initial Public Offering (IPO) is a remarkable period in the life of firms when they transition from private status to public firm status. This paper examines how initial public offering (IPO) audit contingent fees influence post-IPO earnings reversals within the unique institutional environment of Nigeria. We ground this study in agency and institutional theories, and argue that contingent fee arrangements erode auditor independence. Thus, when auditors' independence is compromised, auditors may lack the capacity to sufficiently challenge pre-IPO managerial behavior that could facilitate earnings management that subsequently unwinds in the post-listing period. We analyzed a longitudinal dataset of 50 non-financial firms listed on the Nigerian Exchange from 2010 to 2024, comprising 350 firm-year observations. Our panel regression results indicate that a positive and significant association exists between contingent fees and earnings reversals ($\beta = 1.143$, $p < 0.01$). Further analysis shows that ownership structure moderates this relationship; however, the effect is considerably attenuated among state-owned enterprises ($p < 0.10$). We attribute this finding to heightened regulatory oversight by the Fiscal Responsibility Commission. Consequently, we recommend that Nigeria's Securities and Exchange Commission and Financial Reporting Council enhance their supervision of IPO audit fee disclosures and prohibit outcome-contingent fee arrangements.

Keywords: IPO audit contingent fees; earnings reversal; audit independence; ownership structure; Nigeria
Subject Categories: Auditing; Corporate Governance; Capital Markets

1. INTRODUCTION

The initial public offering (IPO) is one of the most pivotal milestones in the lifecycle of firms. It marks a strategic transition period, when a firm moves from the status of a private company to a public organization. Going public, among other benefits, equips the firm to access equity in the formal capital market. Yet, the quality of firms that access capital through the IPO channel in the capital markets has remained a central debate among regulators, investors, and scholars globally (Carter & Manaster, 1990; Teoh et al., 1998). Nigerian IPO firms are not exceptional, and concerns about how audit contingent fees impact post-listing financial reporting have also taken center stage among investors and academics, though with no recourse to post-listing earnings reversal. In Nigeria, the capital market has witnessed renewed vigor following post-2017 regulatory reforms by the Securities and Exchange Commission (SEC). Despite the reforms and debates, a fundamental and unresolved question has persisted for nearly a decade. To be specific, it is not clear to what extent the contractual features of audit engagements, in terms of audit contingent fees, during the IPO process shape firms' post-listing earnings reversal.

From the theoretical perspective, the function of a capital market depends on independent and professional audit services. Generally, auditors act as critical gatekeepers, guarding investors from potential expropriatory behavior by firm agents, by carrying out substantive audit work and offering quality assurance services to shareholders. However, their independence may be compromised when fee arrangements create economic dependence or when they are generally bonded economically with fees from particular firms or clients (Jensen & Meckling, 1976; Watts & Zimmerman, 1986). Agency theory tries to offer some explanations by suggesting that auditors constrain managerial opportunistic behaviour of CEOs that would likely undermine the quality of firms' earnings. But this ability to limit CEOs from opportunistic behavior seems to be rendered ineffective in the context of IPO auditor compensation in the form of a contingent fee. In this context, contingent fee arrangements in IPO audits may undermine auditors' independence because the fees depend on successful listing, which traps the auditors into effecting performance. Compromise may be activated to achieve the listing, which in turn may reduce audit quality. Conversely, resource-based arguments raise theoretical tension by challenging this agentic view and suggesting that such fees only reflect auditors' input of effort, due diligence, and resource dedication throughout the audit process. As such, such compensation would not likely reduce their audit effectiveness (Mitra et al., 2009; Doogar et al., 2015). This theoretically contested determinant of post-IPO performance remains unexplored in the Nigerian economic context.

This tension has largely been resolved in developed economies. In fact, there, the effect of IPO contingent fees and the earnings reversal nexus has been well examined, although the results provide mixed empirical impact (Chen et al., 2022; Yu et al., 2026). Unfortunately, Nigerian studies have focused away from the reality of the IPO contingent fees–earnings reversal effect to concentrate on either earnings management determinants (Uwuigbe et al., 2017) or audit pricing determinants (Izedonmi & Ibadin, 2013). The lopsided attention has left the core theoretical debate unaddressed and completely ignored. Interestingly, Nigeria constitutes a distinctive and illuminating natural laboratory because it is typically characterized by weak regulatory enforcement, concentrated ownership structures, and a post-2014 market-driven audit pricing regime. These are features that occasion ambiguity in the IPO contingent fees–earnings reversal theoretical framing and discussion. As a result of the deregulation of audit fees in 2014, the Financial Reporting Council of Nigeria has raised concerns about results-oriented fee structures reminiscent of the contingent arrangements documented by Yu et al. (2026) in China. By implication, the contingency audit fee might be yielding reversal effect on earnings with little or no understanding of the extent of the effect and the boundary of the effect in terms of its impact moderating factors. Does state ownership attenuate the potential impact of IPO audit contingent fee on post-listing earnings reversal? To the best of our knowledge, no study in Nigeria has attempted to provide an answer, reinforcing the importance of this study.

Therefore, the main aim of this study is to understand how IPO audit contingent fee drives firms' post-listing earnings reversal. Specifically, the study aims first to examine whether an increase in the IPO audit contingent fee leads to greater

post-IPO earnings reversal. Then, secondly, to determine whether the positive association between IPO audit contingent fees and earnings reversal is weaker for state-owned enterprises than for non-state-owned enterprises. We conceptualize earnings reversal as the management of earnings where firms began to undo or write down through accrual management the earnings previously inflated in order to gain listing success. This kind of behaviour has important ramifications on the quality of reported earnings.

To achieve the above specific objectives, this study sampled 50 IPO Nigerian firms from 2010 to 2024 to analyze the potential effect IPO audit contingent fees yield on earnings reversal of the firms. Our analysis showed that higher IPO audit contingent fees are positively associated with post-IPO earnings reversal, consistent with auditor independence impairment. However, this effect is moderated by ownership structure, echoing Yu et al. (2026)'s finding that the positive relationship between IPO audit contingent fees and subsequent post-IPO earnings reversal is more salient for non-state-owned enterprises. By implication, firms substantially reversed earnings after successful IPO performance, though pronounced among politically connected firms. Based on these findings, we contribute in three important ways. First, we provide robust evidence from an underexplored Nigerian context. Second, we demonstrate that ownership structure moderates this relationship. Third, we show that regulatory oversight intensity attenuates the adverse effects.

1.2 Hypothesis Development

1.2.1. IPO Audit Contingent Fees and Earnings Reversal

We draw from agency theory to posit that auditors facing contingent fee arrangements face conflicts of interest that distort incentive structures and reduce the effort devoted to audits (Choi et al., 2010; Yu et al., 2026). Yu et al. (2026) argued that when audit fees are contingent upon clients' successful listings, audit firms may prioritize the pursuit of contingent fee income. As a result, they often compromise their professional ethics. This may result in an intentional reduction of substantive testing or other essential audit procedures. After listing, the frequent reversal of such short-term earnings management reveals the firm's inherent fundamentals, which leads to the deterioration of performance.

As regards the empirical evidence, the extant literature provides mixed evidence. Studies in developed markets suggest that abnormal fees may reflect audit effort (Doogar et al., 2015). However, in emerging market evidence indicates that contingent fee arrangements intensify conflicts of interest (Chen et al., 2022). In Nigeria, Uwuigbe et al. (2017) found that firms manage earnings before engaging in IPO. However, there is no study to date that has examined whether this relationship holds under conditions of contingent audit pricing.

Therefore, we hypothesize:

H1: The higher the IPO audit contingent fee, the greater the extent of post-IPO earnings reversal.

1.2.2. The Moderating Role of Ownership Structure

Property rights are a crucial determinant of corporate governance in Nigeria. Firms with different ownership structures face distinct incentives and constraints (Xin et al., 2007). Li & Zhou (2013) found that state-owned enterprises (SOEs) are more likely to obtain IPO approval because they have a political advantage. They are also subject to more stringent external oversight. In contrast, non-SOEs face stronger demands for external financing. Thus, they are more motivated to engage in earnings manipulation. Yu et al. (2026) found that IPO audit contingent fees significantly attenuate post-IPO earnings reversals in SOEs.

Thus, we hypothesize:

H2: The positive association between IPO audit contingent fees and earnings reversal is weaker for state-owned enterprises than for non-state-owned enterprises.

2. CONCEPTUAL REVIEW AND THEORETICAL FRAMEWORK

2.1 Conceptual Review

This section provides a systematic elaboration of the core constructs underpinning this study, specifically earnings reversal, IPO audit contingent fees, auditor independence, and ownership structure.

2.1.1 Earnings Reversal

Earnings reversal refers to a phenomenon in which a firm's reported earnings decline significantly in the post-IPO period relative to the pre-IPO period. This observed decline is frequently attributable to the unwinding of earnings management practices that were employed to present a more favorable financial position prior to the firm's public listing (Lu et al., 2015; Yu et al., 2026). At its conceptual core, the notion of earnings reversal aligns with the broader accounting principle that earnings tend to revert to a long-term mean over time (Fama and French, 2000). In the specific context of initial public offerings, the presence of an earnings reversal implies a subsequent correction of pre-IPO earnings figures, which were potentially inflated to influence investor perceptions (Teoh et al., 1998). Das et al. (2008) posited that systematic patterns of earnings reversal serve as empirical indicators of prior earnings management activities. For the purposes of quantification, earnings reversal can be operationalized as the differential between the pre-IPO and post-IPO return on assets (ROA) (Yu et al., 2026).

2.1.2 IPO Audit Contingent Fees

IPO audit contingent fees constitute a form of contractual arrangement wherein the compensation received by the auditor is made conditional upon the successful completion of the client's public listing (Yu et al., 2026). As defined by the American Institute of Certified Public Accountants, a contingent fee is "a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained" (AICPA, 1991, ET Section 302.01). A central concern surrounding such arrangements lies in their inherent potential to compromise auditor objectivity and independence (Bratton, 2003; Marnet, 2007). Regulatory bodies have explicitly addressed this risk, with PCAOB Rule 3521 stipulating that contingent fee agreements with audit clients represent a direct violation of independence standards. In line with the methodological approach adopted by Yu et al. (2026), the measurement of IPO audit contingent fees in this study is calculated as the total IPO audit fees less three times the first-year post-listing audit fees, scaled by the firm's pre-IPO total assets.

2.1.3 Auditor Independence

Auditor independence is conceptualized as a multidimensional construct encompassing the auditor's capacity to render objective and unbiased professional judgments, free from the distorting influences of client affiliations or economic reliance (DeAngelo, 1981; Marnet, 2007). The construct is conventionally delineated into two distinct dimensions: independence in fact, which pertains to the auditor's mental state of objectivity, and independence in appearance, which concerns the perceptions of external stakeholders regarding that objectivity (Mautz and Sharaf, 1961). From the theoretical vantage point of agency theory, auditors function as critical monitoring mechanisms designed to constrain managerial opportunism (Jensen and Meckling, 1976; Watts and Zimmerman, 1986). Within the IPO setting, specific threats to independence become particularly salient. The engagement is characteristically a non-recurring event, which may attenuate the auditor's reputational concerns, while the structure of contingent fee arrangements creates a direct pecuniary interest in the successful outcome of the listing process.

2.1.4 Ownership Structure

Ownership structure delineates the distribution of equity ownership across heterogeneous categories of shareholders and captures the concentration of voting rights as well as the identity of controlling shareholders (Zattoni and Kumar, 2017). As articulated by Zattoni and Kumar (2017, p. 292), "ownership structure defines the agency problems a company faces." Accordingly, firms characterized by concentrated ownership structures are more predisposed to Type II agency problems, which manifest as conflicts of interest between controlling and minority shareholders. In the Nigerian institutional environment, the salience of ownership structure is amplified by the prevalence of high ownership concentration, state-owned enterprises (SOEs), and firms with political connections (Uwuigbe et al., 2017). While SOEs may be subject to heightened regulatory oversight through mechanisms such as the Fiscal Responsibility Commission, which can serve to mitigate opportunistic behaviors (Li and Zhou, 2013), non-SOE entities exhibit greater reliance on external financing and operate under comparatively weaker monitoring regimes. Consequently, these non-SOE firms may demonstrate increased vulnerability to the independence-compromising effects of contingent fee arrangements (Yu et al., 2026).

2.2 Empirical Review

The empirical literature on IPO performance and audit pricing has developed along two interrelated but insufficiently connected streams of research. The first stream documents the pervasive phenomenon of IPO underpricing and its subsequent long-run reversal. The second stream examines how audit fee structures affect auditor behavior and earnings quality. However, the specific mechanism of contingent fees, where auditor compensation depends on listing success, has remained strikingly underexplored, particularly in frontier African markets.

Early international evidence established the magnitude of IPO anomalies. Teoh, Welch, and Wong (1998) used a large sample of US IPOs to demonstrate that pre-IPO earnings management through discretionary accruals is systematically followed by post-IPO earnings reversals, because inflated performance unwinds after listing. Carter and Manaster (1990) showed that underwriter reputation mitigates information asymmetry; however, they did not examine auditor-specific fee arrangements. Choi, Kim, and Zang (2010), in their cross-country study, found that abnormally high audit fees impair audit quality by fostering economic dependence between auditors and clients. This finding directly informs the contingent fees debate. Yu et al. (2026) extend this logic to the IPO context and propose a direct measure of IPO audit contingent fees. They established a positive association between such fees and post-IPO earnings reversal in China, and attributed the effect to compromised auditor independence.

The theoretical predictions are not unanimous, however. Doogar, Sivadasan, and Solomon (2015) provide evidence that higher audit fees may simply reflect additional audit effort and due diligence, not necessarily impairing quality. Similarly, Mitra, Deis, and Hossain (2009) found that in the post-Sarbanes-Oxley regime, higher fees were associated with better earnings quality. These two conflicting perspectives—namely, the "independence impairment" view and the "effort compensation" view—have been tested mainly in developed markets. Their validity in emerging economies has not been largely tested.

In Nigeria, the empirical findings are more fragmented. Uwuigbe, Peter, and Oyeniyi (2017) confirmed that Nigerian listed firms engage in earnings management but did not link this behavior to IPO audit fee structures. Izedonmi and Ibadin (2013) examined the determinants of audit fees in Nigerian companies and found that firm size and complexity are primary drivers; however, they did not isolate contingent components, nor did they examine post-IPO consequences. Olajide (2025) provided more direct evidence, showing that audit pricing significantly affects earnings management among non-financial listed firms in Nigeria. Awa and Obinabo (2020) found that auditor independence and audit firm size positively influence shareholder returns, while auditor tenure has a negative effect. More subtly, Egiyi (2022) documented that high audit fees can threaten auditor independence, impair audit quality, resonating with the independence impairment logic.

For evidence obtained beyond Nigeria and across Africa, Aboukari and Moussa (2020) found that long-run underperformance is robust and that the institutional quality of the listing country significantly moderates the magnitude of this underperformance. In Mauritius, auditor reputation was found to affect IPO return positively. In North Africa, managerial ownership is strongly associated with long-term performance, while concentrated ownership simultaneously reduces underpricing and improves long-term outcomes. These cross-country variations underscore the importance of local institutional context—a theme central to the present study's theoretical framework.

Finally, the agency and institutional theories that underpin this study have received empirical support in related studies. Jensen and Meckling (1976) and Fama and Jensen (1983) established the foundational logic that auditors act as monitors to mitigate principal-agent conflicts but argue that their effectiveness depends on independence. Akerlof's (1970) "lemons" problem captures the severe information asymmetry that characterizes IPO markets. Hill and Jones (1992) extended stakeholder-agency theory, while North (1990) and Young et al. (2008) demonstrated how institutional voids in emerging economies exacerbate both agency problems and governance challenges. Li and Zhou (2013) and Xin, Lin, and Wang (2007) provided evidence that ownership structure—particularly state ownership—changes corporate incentives and oversight intensity, directly relevant to the moderating role examined in this study.

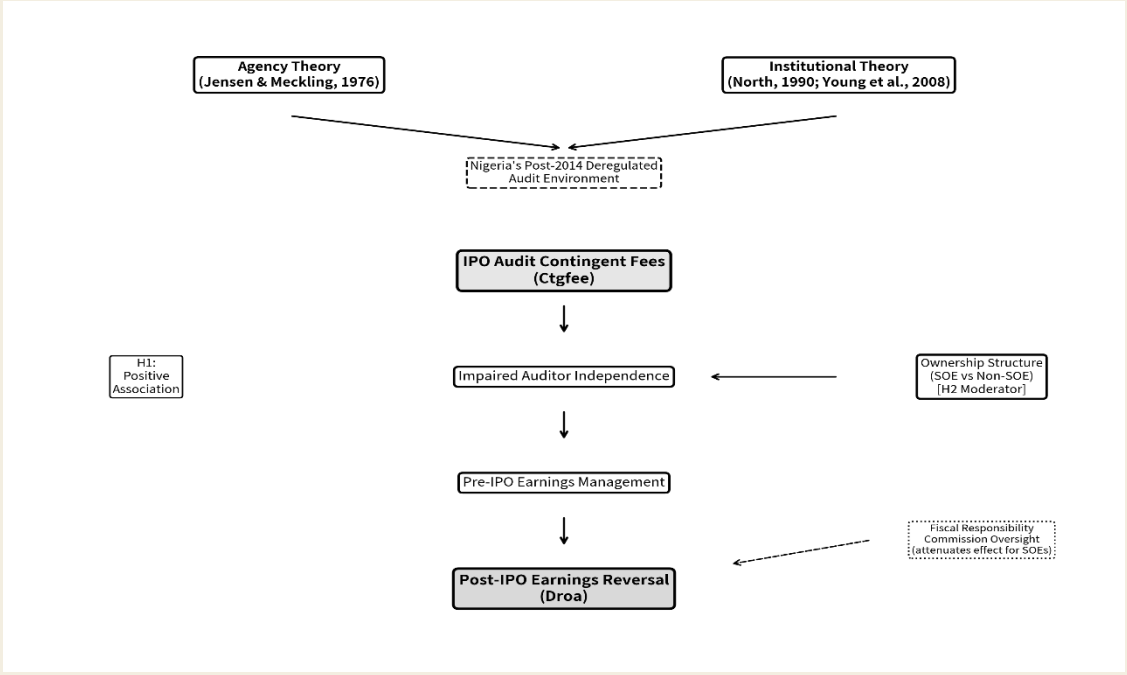
In fact, there is cumulative evidence of the potential for IPO audit contingent fees to impact earnings reversal. However, we did not find any prior study that brought the three elements—namely audit fees contingent on IPO success, pre-listing earnings management, and post-listing earnings reversal—into a unified causal framework for direct testing. The present study therefore fills this gap by empirically testing whether IPO audit contingent fees drive post-IPO earnings reversal and whether state ownership attenuates this adverse effect.

2.3. Theoretical Framework

We anchored our framework on agency theory, which posits that separation of ownership and control creates conflicts of interest that governance mechanisms aim to mitigate (Jensen & Meckling, 1976; Fama & Jensen, 1983). In the IPO context, information asymmetry is most pronounced (Akerlof, 1970). It creates opportunities for pre-listing earnings management that subsequently reverses. Auditors serve as monitoring mechanisms; however, their independence may be compromised when audit fees are contingent on the clients' success in the listings of their shares (Yu et al., 2026).

However, agency theory's narrow focus on shareholder wealth maximization fails to adequately explain organizational responses to societal pressures (Hill & Jones, 1992). We therefore integrate institutional theory (North, 1990), which argues that firms manage relationships with multiple constituent groups to ensure long-term survival. It also proposes that institutional voids, which characterize emerging markets, exacerbate both agency problems and stakeholder pressures (Young et al., 2008). Nigeria's hybrid institutional environment, which features weak formal enforcement but strong informal networks, creates direct theoretical ambiguity regarding auditor behaviour. As illustrated in Figure 1, we anchor IPO audit contingent fees within agency theory's principal-agent conflicts and institutional theory's emphasis on emerging market voids.

FIGURE 1. ***Theoretical Framework and Hypotheses Development***



The diagram illustrates how agency theory and institutional theory, situated within Nigeria's post-2014 deregulated audit environment, channel through IPO audit contingent fees to impair auditor independence, thereby enabling pre-IPO earnings management that subsequently reverses after listing. Ownership structure (SOE vs. Non-SOE) moderates the main pathway (H2), with the Fiscal Responsibility Commission providing additional oversight for state-owned enterprises.

3. METHODOLOGY

3.1 Research Design and Sample

This study employs an ex-post facto research design utilizing secondary data. We deem this design appropriate given that the independent variable—IPO audit contingent fees—is not subject to manipulation, and the analysis pertains to events that have already transpired (Kerlinger & Lee, 2000). The initial population comprised all non-financial firms that undertook an initial public offering on the Nigerian Exchange Group (NGX) between 2000 and 2024. As of January 2026, a total of 146 firms were listed across the NGX Main Board and the Alternative Securities Market under the purview of the Nigerian SEC.

From this initial population, we applied purposive sampling guided by specific exclusion criteria. First, we exclude all 42 financial firms, as banks and insurance companies operate under distinct capital structures and accounting practices that would confound the analysis. Second, we eliminate 54 firms for which data is incomplete; specifically, we require available data for a window of three years preceding and following the IPO event, as well as detailed audit fee disclosures. The application of these criteria yields a final sample of 50 firms. For each of these firms, we collect data across a seven-year window (t−3, t−2, t−1, t, t+1, t+2, t+3), resulting in a total of 350 firm-year observations.

3.2 Variable Definition

Earnings Reversal (Droa): In line with the study by Lu et al. (2015) and Yu et al. (2026), we measure Droa as the difference between the return on assets of the year before the IPO and the return on assets of the year after the IPO.

IPO audit contingent fees (Ctgfee): In line with the theory of contingent arrangement, we measure Ctgfee as the IPO fees paid to the auditing firm, excluding three times the audit fees of the first-year financial statements after the IPO, divided by the total assets of the year before the IPO.

Control variables: In line with the study by previous authors, the control variables are IPO proceeds (Proceed), size of the company (Size), debt-to-asset ratio (Lev), profitability (ROE), operating risk (Risk), ownership structure of the company (Soe), company age (Age), whether the company was audited by a Big 4 auditing firm (Big4). The variables are fully summarized in Table 1 below.

TABLE 1. *Summary of Variables, Definitions, and Measurements*

VARIABLE	ABBREVIATION	DEFINITION	MEASUREMENT
Earnings Reversal	*Droa*	The decline in a firm's profitability from the pre-IPO period to the post-IPO period.	Difference in ROA between the year before and the year after IPO. Droa = ROA(t−1) − ROA(t+1)
IPO Audit Contingent Fees	*Ctgfee*	The portion of IPO audit fees contingent upon the success of the listing.	(IPO Audit Fees − 3 × Post-IPO Year 1 Audit Fees) / Pre-IPO Total Assets
Ownership Structure	*Soe*	Binary classification distinguishing state-owned from non-state-owned enterprises.	Dummy: 1 = state-owned enterprise (SOE); 0 = non-state-owned enterprise
Interaction Term	*Ctgfee × Soe*	Product of contingent fee and ownership dummy; tests the moderating hypothesis (H2).	Ctgfee multiplied by Soe
IPO Proceeds	*Proceed*	Total funds raised by the firm from the initial public offering.	Natural logarithm of total IPO proceeds
Company Size	*Size*	Scale of the company's operations.	Natural logarithm of total assets
Profitability	*ROE*	A measure of financial performance.	Return on Equity: Net Income / Shareholders' Equity
Leverage	*Lev*	Degree of financial leverage.	Debt-to-asset ratio: Total Debt / Total Assets
Operating Risk	*Risk*	Volatility or uncertainty of the firm's operations.	Standard deviation of operating cash flows scaled by total assets
Company Age	*Age*	Maturity of the company at time of IPO.	Natural logarithm of years since incorporation
Auditor Reputation	*Big4*	Whether the firm's audit was conducted by a top-tier international audit firm.	Dummy: 1 = Big 4 auditor (PwC, KPMG, EY, Deloitte); 0 = otherwise

Source: Authors' Compilation (2026). Droa = earnings reversal; Ctgfee = IPO audit contingent fees; Soe = state-owned enterprise dummy; ROE = return on equity; Lev = leverage; Big4 = Big 4 auditor dummy.

3.3 Model Specification

We follow the study by Lu et al. (2015) and Yu et al. (2026) by estimating the following models:

Model 1 (H1):

$$Droa = \beta 0 + \beta 1 Ctgfee + aControls + \mu i + \lambda t + \varepsilon it$$

Model 2 (H2):

$$Droa = \beta 0 + \beta 1 Ctgfee + \beta 2 Soe + \beta 3 (Ctgfee \times Soe) + aControls + \mu i + \lambda t + \varepsilon it$$

Where β represents the parameters, α represents the parameters of the control variables, μi represents the industry fixed effects (or firm fixed effects in robustness tests), λt represents the year fixed effects, and εit represents the standard errors clustered at the firm and year levels.

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics and Validity Tests

Table 2 shows the results of the descriptive statistics. The average Droa is 0.072, implying that, on average, IPO firms in Nigeria experience a 7.2% decrease in ROA after going public, which is consistent with the earnings reversal phenomenon observed by Yu et al. (2026) in China, with an average of 0.068. The average Ctgfee is 0.004, implying that, on average, the contingent fees paid by IPO firms in Nigeria account for 0.4% of their pre-IPO assets. Interestingly, 67% of the IPO firms are audited by the Big 4, emphasizing the market concentration of the auditing industry in Nigeria.

TABLE 2. *Descriptive Statistics*

VARIABLE	N	MEAN	STD. DEV.	P25	P50 (MEDIAN)	P75
Droa	350	0.072	0.071	0.025	0.058	0.106
Ctgfee	350	0.004	0.005	0.001	0.003	0.006
Proceed	350	10.845	0.712	10.321	10.762	11.284
Size	350	20.267	0.984	19.612	20.145	20.783
ROE	350	0.231	0.098	0.162	0.215	0.283
Lev	350	0.441	0.159	0.312	0.442	0.561
Age	350	2.512	0.495	2.303	2.565	2.833
Soe	350	0.092	0.289	0.000	0.000	0.000
Big4	350	0.670	0.470	0.000	1.000	1.000

Source: This table reports descriptive statistics for all variables over the full sample of 350 firm-year observations drawn from 50 Nigerian IPO firms listed on the NGX, 2010–2024. Droa = post-IPO earnings reversal; Ctgfee = IPO audit contingent fees scaled by pre-IPO total assets; Proceed = natural log of IPO proceeds; Size = natural log of total assets; ROE = return on equity; Lev = debt-to-asset ratio; Age = natural log of firm age; Soe = state-owned enterprise dummy; Big4 = Big 4 auditor dummy.

In line with Yu et al. (2026), we search for initial support for our proposed measure, Ctgfee. Our results indicate that firms paying above-median contingent fees exhibit greater discretionary accruals (mean diff = 0.003, $p < 0.05$) and are more likely to undergo financial restatements (mean diff = 0.004, $p < 0.10$). This supports the notion of lower earnings quality in the presence of contingent fees.

4.2 Baseline Regression: Testing H1

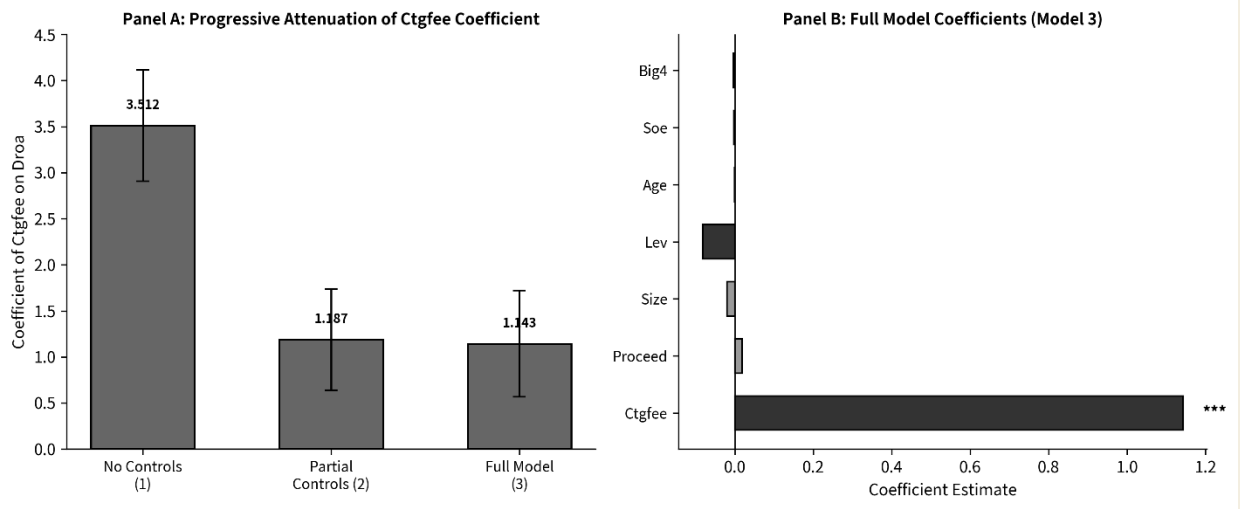
In Table 3, we present the baseline results. In Column (1), we exclude control variables, and we observe a substantially positive coefficient on Ctgfee. In Column (3), we include all control variables, and we continue to observe a positive coefficient on Ctgfee, which is statistically significant at the 1% level ($\beta = 1.143$, $t = 3.892$). A one-standard-deviation increase in Ctgfee is associated with a 0.55% decrease in post-IPO ROA, or 7.6% of the mean. Our results support H1, which is in line with Yu et al. (2026), as they posit that IPO audit contingent fees lead to a conflict of interest between auditors and stakeholders, damage audit independence, and ultimately result in post-IPO earnings reversals.

TABLE 3. *Baseline Regression—IPO Audit Contingent Fees and Earnings Reversal*

VARIABLES	DROA (1)	DROA (2)	DROA (3)
Ctgfee	3.512***	1.187***	1.143***
	(11.412)	*(4.231)*	*(3.892)*
Proceed		0.023***	0.019**
		(8.542)	*(5.382)*
Size		−0.021***	−0.020***
		(−8.681)	*(−8.442)*
Lev		−0.081***	−0.082***
		(−10.521)	*(−10.534)*
Age		−0.001	−0.001
		(−0.452)	*(−0.412)*
Soe		−0.002	−0.002
		(−0.781)	*(−0.702)*
Big4		−0.003	−0.003
		(−1.398)	*(−1.371)*
Other fees	No	No	Yes
Constant	0.054***	0.198***	0.131*
	(28.682)	*(5.852)*	*(1.962)*
Industry FE	Yes	Yes	Yes
N	350	350	350
Adj. R^2	0.181	0.518	0.518

*Source: t-statistics are reported in parentheses. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. Standard errors are clustered at both the firm and year levels. All models include industry and year fixed effects. Droa = post-IPO earnings reversal; Ctgfee = IPO audit contingent fees; Proceed = natural log of IPO proceeds; Size = natural log of total assets; Lev = debt-to-asset ratio; Age = natural log of firm age; Soe = state-owned enterprise dummy; Big4 = Big 4 auditor dummy.*

FIGURE 2. ***Graphic Illustration of Baseline Regression Results***



Panel A shows the progressive attenuation of the Ctgfee coefficient across the three nested models (from 3.512 in the no-control specification to 1.143 in the full specification), confirming robustness to covariate inclusion. Panel B displays all estimated coefficients from the fully specified Model 3, highlighting the dominant positive effect of contingent fees (β = 1.143, p < 0.01) relative to control variables. Error bars in Panel A denote approximate 95% confidence intervals.

4.3 Moderating Role of Ownership Structure: Testing H2

In Table 4, we present H2 results. The coefficient of the interaction term (Hctgfee × Soe) is negative and significant (p < 0.10), which indicates that IPO audit contingent fees significantly attenuate post-IPO earnings reversals in SOEs. This finding supports Yu et al. (2026)'s study where it was reported that the positive relationship between IPO audit contingent fees and subsequent post-IPO earnings reversal is more salient for non-state-owned enterprises. In the Nigerian context, SOEs face more stringent external oversight through the Fiscal Responsibility Commission, which may constrain auditor-client collusion.

TABLE 4. *Moderating Effect of Ownership Structure*

VARIABLES	DROA
Hctgfee	0.006**
	(2.312)
Soe	0.004
	(1.042)
Hctgfee × Soe	−0.012*
	(−1.712)
Controls	Yes
Industry FE	Yes
Year FE	Yes
N	350
Adj. R^2	0.509

*Source: t-statistics are reported in parentheses. *** and ** and * indicate significance at the 1%, 5%, and 10% levels, respectively. Hctgfee = high contingent fee dummy (above-median). All models include industry and year fixed effects. Standard errors are clustered at the firm and year levels.*

4.4 Robustness Tests

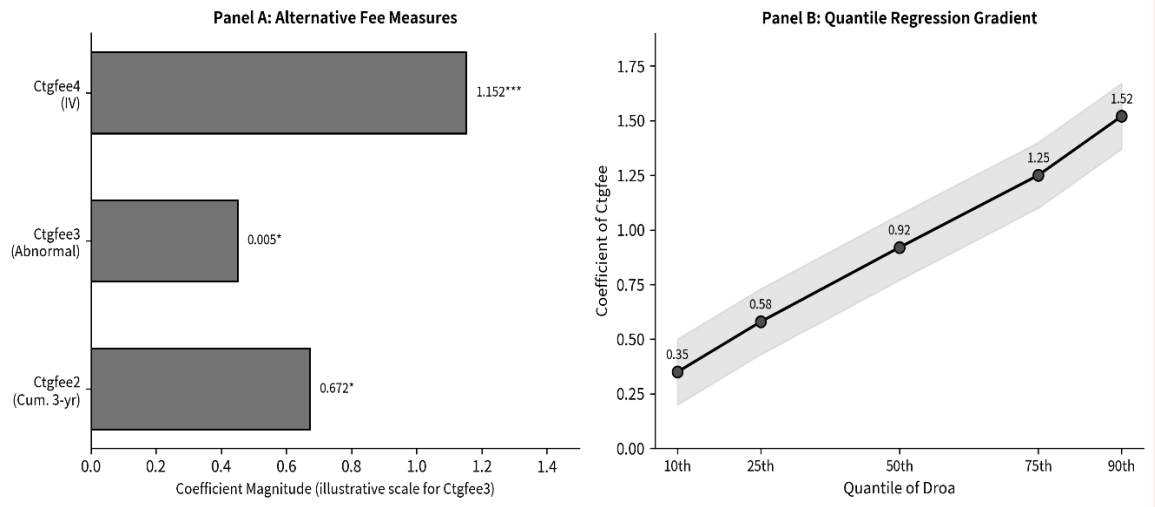
To address the problem of endogeneity, we performed robustness tests, which addressed the possible concerns as shown in Table 5 below. First, we utilized the lagged regional IPO withdrawal ratio as an instrument. The results showed that the Ctgfee coefficient is consistent, remaining positive and significant at the 10% level. Second, we followed the recommendations of Yu et al. (2026), who utilized alternative measures of the instrument: Ctgfee2 (cumulative three-year post-IPO audit fees) and Ctgfee3 (abnormal audit fees from residual model). The results were still consistent with the previous findings. Third, we utilized quantile regression analysis, which still showed that the effect of IPO audit contingent fees increases as the degree of post-IPO earnings reversal increases.

TABLE 5. *Robustness Tests—Alternative Measures and Instrumental Variable Estimation*

VARIABLE	DROA (1)	DROA (2)	DROA (3)
Ctgfee2	0.672*		
	(1.892)		
Ctgfee3		0.005*	
		(2.341)	
Ctgfee4			1.152***
			(3.912)
Controls	Yes	Yes	Yes
N	623	623	623
Adj. R^2	0.521	0.512	0.518

*Source: t-statistics are reported in parentheses. *** and * indicate significance at the 1% and 10% levels, respectively. Ctgfee2 = cumulative three-year post-IPO audit fees; Ctgfee3 = abnormal fees from residual model; Ctgfee4 = IV regression using lagged regional IPO withdrawal ratio. Expanded sample of N = 623 reflects additional firm-year observations used in robustness specifications.*

FIGURE 3. ***Robustness Test Results***



Panel A confirms coefficient stability across three alternative fee proxies (Ctgfee2, Ctgfee3, Ctgfee4), all yielding positive and statistically significant estimates, corroborating the main finding. Panel B presents quantile regression estimates showing a monotonically increasing gradient from the 10th to the 90th percentile (0.35 to 1.52), demonstrating that the independence-impairing effect of contingent fees is most pronounced among firms experiencing the most severe earnings reversals, consistent with agency theory predictions.

4.5 Additional Analysis: IPO Speed and Auditor Retention

Following Yu et al. (2026), we examine the economic consequences of IPO audit contingent fees. Higher contingent fees significantly shorten IPO listing cycles ($\beta = -7.612$, $p < 0.01$) and increase the duration of continuous auditor tenure ($\beta = 22.934$, $p < 0.01$). These findings suggest that audit firms receiving higher contingent fees are more likely to collaborate with their client firms to expedite the IPO listing and develop interests that are convergent with those of their audit suppliers.

5. DISCUSSION

5.1 Theoretical Contribution: Auditor Independence Impairment Perspective

This study found that in opaque environments such as Nigeria, the pricing of audits changes. Fees are no longer merely a reward for effort. Contingent fees constitute and rather impose a risk of impairment on auditor independence. This finding contradicts Doogar et al. (2015) and Mitra et al. (2009), who argue that higher contingent fees are associated with effort and due diligence. However, our finding supports the work of Yu et al. (2026), who found that these contingent fees increase conflicts of interest, decrease audit effort, and lead to impaired financial reporting.

The analysis confirms H1, with a positive and significant relationship between IPO audit contingent fees and earnings reversal ($\beta = 1.143$, $t = 3.892$). This supports agency theory because auditor independence is being driven by the contingent fees. By implication, contingent fees are used as a measure of successful listing, which leads auditors to prioritize fee income rather than ethics and independence. We confirm that when contingent fees increase by one standard deviation, post-IPO ROA decreases by 7.6% relative to the mean of the sample distribution.

Our finding agrees with Lin et al. (2018), who found that positive abnormal audit fees damage audit quality when the accrual reverses. In emerging markets, the effort effect is dominated by the independence impairment effect, because ownership-control conflict undermines governance as proposed by Jensen & Meckling (1976).

5.2 Boundary Conditions: Moderating Effect of Ownership Structure

We also found a consistent result, which aligns with prior researchers, that the relationship between IPO contingent fees and post-IPO earnings reversal is stronger in the case of non-state-owned enterprises. However, we differ by deviating from the straightforward resource-based approach in the context of emerging markets. Our finding emphasizes the importance of the boundary condition of institutional transparency.

We found a statistically significant interaction effect (Hctgfee × Soe: $\beta = -0.012$, $p < 0.10$). This shows that state-owned enterprises benefit from the IPO approval process through political connections, as well as oversight consistent with the argument of Li and Zhou (2013). In the Nigerian case, we show that the Fiscal Responsibility Commission helps to reduce the problem related to auditor-client collusion. Thus, for state-owned firms, IPO audit contingent fees do not weaken the independence of auditors.

5.3 Additional Economic Consequences

Our finding has additional economic ramifications. While IPO contingent fees reduce the duration of the IPO audit process and promote cooperation between the auditor and client in the long term, as argued by extant literature, they are associated with lower long-run IPO market performance. Deterrence theory is not sufficient to explain this reduced long-term performance. However, agency theory adequately explains the economic consequences of IPO audit contingent fees and earnings deflation after successful IPO listing.

6. IMPLICATIONS, LIMITATIONS AND CONCLUSION

6.1. Implications

The paper has some implications for improving the earnings quality of listed companies. First, there should be strong enhancement of auditors' independence during the IPO period. Since audit contingent fees weaken auditors' independence, which leads to poor substantive tests or audits, the boards should strengthen their watchdog role. Collusion between auditors and CEOs should be reduced by monitoring when the contingent fee is inflated to bond the auditors. Prohibiting results-oriented fee arrangements, as China did in 2023, may improve independence. Nevertheless, confidence can be placed in the earnings reports of IPO firms a few years following their successful share listing, as the firms would potentially be reporting deflated and correct earnings. For Nigerian regulators such as the SEC and FRC, the findings imply that the contractual features of IPO audit fees significantly impact post-IPO performance. For investors, the findings may help evaluate their investment portfolio.

6.2. Limitations

The paper recognizes several limitations. Measurement difficulties persist. Contingent fees may exist in reality, and detecting hidden contingent fees in publicly available data may cause measurement bias (Yu et al., 2026). The proxy may not accurately reflect reality because audit covenants are private. In addition, contingent fees are related to audit quality, risk, and other variables, with impacts varying due to unobservable variables such as market conditions and regulatory pressures (Yu et al., 2026).

Nevertheless, we took several steps to ensure the robustness and reliability of our findings. First, we implemented a series of robustness tests, including instrumental variable regression using the lagged regional IPO withdrawal ratio as an instrument. Furthermore, we verified our results using alternative specifications of contingent fees (Ctgfee2, Ctgfee3) and quantile regression techniques. Second, we incorporated both firm and year fixed effects into our models to control for unobserved heterogeneity across entities and time. Third, we clustered standard errors at both the firm and year levels to account for within-group correlation (Petersen, 2009). Finally, we performed validity checks to support the construct validity of our contingent fee measure. Specifically, we found that firms disbursing above-median contingent fees exhibit significantly greater discretionary accruals (mean diff = 0.003, $p < 0.05$) and a higher likelihood of undergoing financial restatements (mean diff = 0.004, $p < 0.10$).

6.3. Conclusions

This paper examined the impact of IPO audit contingent fees on earnings reversals in Nigeria. Our findings indicated that there is a strong positive relationship between IPO contingent fees and earnings reversals, especially for non-state-owned enterprises. Although contingent fees facilitate IPOs, they were found to be aiding earnings management, which reverses at the end of the IPO. It thus becomes clear that contingent audit fees weaken auditor independence to perform substantive audit work. This conclusion is consistent with Yu et al. (2026), who concluded that the contractual features of IPO audit fees to auditors during IPO is a motivating factor that activates agency problems by creating an environment for earnings management to list shares successfully. However, upon successful completion of the listing, another cycle of manipulation begins to correct the inflated post-IPO performance.

Based on this conclusion, we make the following specific recommendations. First, Nigeria's SEC and the Financial Reporting Council should strengthen oversight of IPO audit fee disclosures. Second, regulators should prohibit results-oriented fee arrangements, similar to China's 2023 reform. Third, boards should enhance their watchdog role during the IPO period to reduce auditor-CEO collusion. Finally, investors should exercise caution when evaluating IPO firms with disproportionately high audit fees relative to industry norms, though this caution may be relaxed for state-connected firms.

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