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Research on the Impact of Real Earnings Management on Abnormal Audit Fees

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Abstract: *This paper takes A-share listed enterprises in China from 2014 to 2023 as research samples to study the impact of real earnings management on abnormal audit fees. The empirical results show that real earnings management significantly increases the abnormal audit fees of enterprises, and this promotion is particularly significant in non-state-owned enterprises and high-tech enterprises. Mechanism tests indicate that real earnings management increases business operational risk, leading to higher audit effort and audit risk compensation for auditors, thereby increasing abnormal audit fees. Moreover, financing constraints strengthen the promotion of real earnings management to abnormal audit fees.*

Keywords: *Real Earnings Management, Abnormal Audit Fees, Operational Risk, Financing Constraints*

1. Introduction

As we all know, corporate earnings management affects stakeholders' judgment and understanding of the company's economic condition, is an important decision-making factor for investors, and has a significant impact on the long-term development of the company. Earnings management mainly includes accrual earnings management and real earnings management. Accrual earnings management involves adjusting a company's accrual items through accounting policies and estimates, thereby altering the company's accounting profit and whitewashing financial statements (Zang, 2012)[1]. Real earnings management is the manipulation of actual transactions by companies, primarily consisting of abnormal production costs, abnormal operating cash flows, and abnormal discretionary expenses (Roychowdhury, 2006)[2]. Earnings management can bring short-term benefits to a company, and good financial performance may attract more investors. However, in the long run, its drawbacks are more prominent, which will not only cause financial information distortion, but also cover up the real business situation of enterprises, resulting in increased fraud risks and operational risks, as well as increased audit risks. Auditors need to invest more audit resources and time to ensure audit quality. Based on the increase of audit input cost and audit risk compensation, auditors need to increase audit fees. The actual audit fees are higher than the expected audit fees, and the abnormal audit fees increase. It can be seen that earnings management will have an impact on abnormal audit fees, and it is necessary to further study the mechanism of earnings management on abnormal audit fees.

According to the audit pricing model constructed by Simonic[3], audit fees include not only audit input cost, but also audit risk premium compensation. Among them, the audit input cost refers to the cost of manpower, material resources and time paid by auditors to ensure the audit quality. It is the cost for auditors to provide reasonable audit services, which is included in the normal audit expenses (Gong et al., 2021)[4]. The audit risk premium compensation refers to the additional costs incurred by auditors due to high operational and litigation risks faced by the audited entity, which in turn increases the audit risk for the auditors. Consequently, auditors will incur extra audit costs and charge risk compensation, and the portion of this risk compensation paid by the enterprise is considered abnormal audit fees (Chen et al., 2020)[5].

At present, the research on earnings management and auditing is relatively rich. Earnings management will increase the risk of material misstatement in financial statements, thus increasing the audit risk (Feng and Wen, 2024)[6]. When auditors perceive the high business risk of enterprises, they will increase audit investment (Yu et al., 2024)[7] and demand additional risk compensation (Yu et al., 2024)[8], which will lead to an increase in actual audit fees, that is, the corresponding abnormal audit fees. Through the above-mentioned related literature, it is found that it is of great significance to study the influence of earnings management on audit field, especially on abnormal audit fees. Due to the

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improvement of accounting legal systems, it has become more difficult for companies to implement earnings management through accrual items. This trend has forced companies to gradually shift towards more covert real earnings management, and also raises higher demands on the ability of certified public accountants to identify real earnings management. Therefore, this paper focuses on the more covert real earnings management, studying its impact on abnormal audit fees and thoroughly exploring the path mechanisms.

2. Theoretical Analysis

2.1 Real Earnings Management and Abnormal Audit Fees

Excessive use of real earnings management will increase the difficulty and complexity of audit work. Certified public accountants can't directly understand the real situation of enterprises, so they need to invest more time, resources, and energy; expand the scope of the audit; and implement more audit procedures to ensure the accuracy of financial reports (Xu et al., 2024)[9]. Due to the consideration of audit input cost, certified public accountants will increase additional audit fees. In addition, due to the high degree of real earnings management of the audited entity, it will increase financial risks and operational risks (Xia and Lai, 2016)[10], leading to an increase in the probability of future business failure. According to the "deep pocket theory", when the auditee has a high litigation risk, the auditor is also the undertaker of the potential risk, and may be jointly and severally liable for litigation because of the company's business failure (Quan and Qian, 2025)[11]. Therefore, due to the consideration of reputation and litigation risk, auditors will directly charge part of the audit risk compensation fee when pricing the audit, which is the increase of abnormal audit fees.

Abnormal audit fees are the difference between actual audit fees and expected audit fees. If the former is higher than the latter, it is considered positive abnormal audit fees; otherwise, it is negative abnormal audit fees. Although the theoretical analysis above has explained that real earnings management can increase audit fees, leading to an increase in corresponding abnormal audit fees, differences in auditors' professional competence and bargaining power may cause real earnings management to have different impacts on positive and negative abnormal audit fees under different circumstances. Specifically, real earnings management increases the degree of information asymmetry, requiring auditors to exert more effort to verify the accuracy of accounting information. The increased audit effort leads to higher audit fees, with actual audit fees exceeding expected audit fees, resulting in an increase in positive abnormal audit fees. At the same time, due to the high level of real earnings management, the quality of accounting information in such companies is relatively poor. To conceal risks or obtain better audit opinions, these companies are motivated to pay higher audit fees and collude with auditors. Therefore, real earnings management will lead to an increase in positive abnormal audit fees. As for negative abnormal audit fees, there will be no significant impact, because real earnings management complicates the audit process, increases the audit risk faced by auditors, and auditors will receive higher audit fees as compensation. Based on this, this paper proposes hypothesis H1.

H1: Real earnings management significantly increases firms' abnormal audit fees, especially positive abnormal audit fees.

2.2 The Mediating Role of Operational Risk

Although real earnings management superficially improves corporate performance and achieves short-term profits, it actually harms the long-term healthy development of the enterprise and significantly increases operational risks (Cao et al., 2023)[12]. Because real earnings management reflects the distortion of resource allocation (Wang et al., 2025)[13], this distortion stems from the fact that enterprises actively deviate from the optimal business decision in order to manipulate financial indicators, resulting in human resources, capital and other resources not flowing to the most efficient or valuable areas, which will make enterprises ignore product quality, gradually reduce market competitiveness, and then it will be difficult to obtain enough funds to maintain normal business activities, forming a vicious circle and increasing business risks. For enterprises with high operational risks, auditors will charge more audit fees. High operational risk means that the effectiveness of internal control of enterprises is low, and it is difficult for auditors to rely on internal control. Therefore, it is inevitable to invest more energy in auditing to obtain sufficient audit evidence and implement stricter audit procedures. Then, the investment in auditing will increase, the labor cost will rise, and the actual audit expenses will inevitably increase.

H2: Real earnings management increases abnormal audit fees by raising operational risk.

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2.3 The Moderating Effect of Financing Constraints

Real earnings management, which is often hidden in daily business activities, has strong concealment and makes the audit work more difficult. In enterprises with high financing constraints, the motivation for real earnings management is stronger (Wang and Wei, 2024)[14], and the promotion of abnormal audit fees is more obvious. Financing constraint is the limit for enterprises to raise funds. If enterprises face higher financing constraint, they will often bear greater operating pressure. These business pressures may prompt enterprises to adopt radical business strategies, and then enterprises will adopt more earnings management methods. Then auditors need to invest more time and resources to identify earnings manipulation. Therefore, with the increase of audit investment, the actual audit fees obtained by auditors should also increase, and the abnormal audit fees should increase. Based on this, this paper proposes hypothesis H3.

H3: Financing constraints strengthen the positive effect of real earnings management on abnormal audit fees.

3. Research Design

3.1 Data Source and Processing

This paper uses A-share listed companies in China from 2014 to 2023 as the research sample and processes the sample as follows: (1) exclude samples from the financial industry; (2) exclude PT, ST and *ST samples (3) exclude samples with missing primary variables. The research data is sourced from the CSMAR database.

3.2 Variable Definition

3.2.1 Real Earnings Management

This paper refers to Roychowdhury(2006) [2]methods to measure the real earnings management degree of enterprises, which is recorded as Absrem. The specific calculation process is as follows: first, based on the following models (1) to (3) categorized by year and industry, calculate the regression residuals, which respectively represent abnormal cash flow from operating activities (A_CFO), abnormal production costs (A_PROD), and abnormal discretionary expenses (A_DISEXP). Second, based on the aforementioned three regression residuals, calculate the degree of real earnings management.

$$\frac{CFO_{it}}{A_{i,t-1}} = \alpha_0 + \alpha_1 \frac{1}{A_{i,t-1}} + \alpha_2 \frac{REV_{it}}{A_{i,t-1}} + \alpha_3 \frac{\Delta REV_{it}}{A_{i,t-1}} + \varepsilon_{it} \quad (1)$$

$$\frac{PROD_{it}}{A_{i,t-1}} = b_0 + b_1 \frac{1}{A_{i,t-1}} + b_2 \frac{REV_{it}}{A_{i,t-1}} + b_3 \frac{\Delta REV_{it}}{A_{i,t-1}} + b_4 \frac{\Delta REV_{i,t-1}}{A_{i,t-1}} + \varepsilon_{it} \quad (2)$$

$$\frac{DISEXP_{it}}{A_{i,t-1}} = c_0 + c_1 \frac{1}{A_{i,t-1}} + c_2 \frac{REV_{it-1}}{A_{i,t-1}} + \varepsilon_{it} \quad (3)$$

$$Absrem_{it} = |(-1)A\_CFO_{it} + A\_PROD_{it} + (-1)A\_DISEXP_{it}| \quad (4)$$

Among them: CFO_{it} represents net cash flow from operations of firm i in year t; $PROD_{it}$ represents enterprise production costs; $DISEXP_{it}$ represents controllable costs of the enterprise; REV_{it} represents operating income of firm i in year t; $A_{i,t-1}$ represents total assets at the end of period t-1.

3.2.2 Abnormal Audit Fees

Based on Simunic's audit pricing model and drawing on the measurement method of abnormal audit fee by Han et al. (2015)[15], this paper defines the regression residual of model (5) as abnormal audit fee (Abfee).

$$LNFEE_{it} = \alpha_0 + \alpha_1 LNASSET_{it} + \alpha_2 ARINV_{it} + \alpha_3 CATA_{it} + \alpha_4 CR_{it} + \alpha_5 ROA_{it} + \alpha_6 LEV_{it} + \alpha_7 LOSS_{it} + \alpha_8 EMPLOY_{it} + \alpha_9 Big_4 + \alpha_{10} TIER2_{it} + \alpha_{11} OFFICESIZE_{it} + \alpha_{12} CHANG_{it} + \alpha_{13} DELAY_{it} + Year + Industry + \varepsilon_{it} \quad (5)$$

3.2.3 Operational Risk

This paper follows the approach of Dong and Sun (2023)[16], using the profit volatility to measure operational risk, which is recorded as OP_RISK.

3.2.4 Financing Constraints

This paper uses FC index to measure the degree of financing constraints, which is recorded as FC.

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3.2.5 Control Variables

The control variables selected in this paper include: company size(Size), debt-to-asset ratio(Lev), net profit margin on total assets(Roa), company age(Age), the shareholding ratio of the largest shareholder(Top1), audit opinion type(Audittype), whether the auditor is from the Big Four(Big4), total compensation of the top three executives(Salary) and board size(Boardsize).

3.3 Model Setting

Firstly, this paper constructs a baseline regression model (6) to verify hypothesis H1. At the same time, all regression models include robust standard errors to mitigate the impact of heteroscedasticity.

$$Abfee_{it} = \beta_0 + \beta_1 Absrem_{it} + \beta_2 Controls_{it} + YEAR + IND + \varepsilon_{it} \quad (6)$$

Among them: i and t respectively represent the enterprise and the year; $Absrem_{it}$ represents the real earnings management level of company i in year t; $Abfee_{it}$ represents the abnormal audit fees of company i in year t.; $Controls_{it}$ represents control variables; IND represents controlling for industry fixed effects; YEAR indicates controlling for time fixed effects; ε_{it} represents the random disturbance term.

Secondly, to examine the mediating role of operational risk, this paper establishes the following models (7) and (8) based on the stepwise regression method by Wen et al. (2004)[17]:

$$OP\_RISK_{it} = \theta_0 + \theta_1 Absrem_{it} + \theta_2 Controls_{it} + YEAR + IND + \varepsilon_{it} \quad (7)$$

$$Abfee_{it} = \beta'_0 + \beta'_1 Absrem_{it} + \beta'_2 OP\_RISK_{it} + \beta'_2 Controls_{it} + YEAR + IND + \varepsilon_{it} \quad (8)$$

Finally, this paper analyzes the moderating effect of financing constraints and establishes Model (9) to verify Hypothesis H4.

$$Abfee_{it} = \alpha_0 + \alpha_1 Absrem_{it} + \alpha_2 FCAb_{it} + \alpha_3 FC_{it} + \alpha_4 Controls_{it} + \eta_t + \delta_i + \varepsilon_{it} \quad (9)$$

Among them: FCAb is the interaction term between financing constraints and real earnings management; FC is financing constraints.

4. Empirical Results

4.1 Descriptive Statistical Analysis and Correlation Analysis

Table 1 shows the descriptive statistical results of the main variables. The minimum value of real earnings management (Absrem) is 0, and the maximum value is 7.128, which shows that the degree of earnings management varies greatly among different enterprises. The maximum value of Abnormal audit fees (Abfee) is 2.916, which is significantly different from the minimum value, indicating that there are significant differences between different enterprises in the sample. The remaining variables are within a reasonable range and will not be discussed in detail.

This paper also uses the Pearson test for correlation analysis. The test results show that the coefficient between real earnings management and abnormal audit fees is 0.027, significantly positive at the 1% level, indicating that real earnings management can increase abnormal audit fees, preliminarily validating the hypothesis H1. From the perspective of control variables, most of the control variables have a correlation with abnormal audit fees, and the absolute values of the coefficients between the variables are all less than.0.5.

Table 1: Descriptive Statistical Analysis

Variable	N	Mean	SD	Min	p50	Max
Abfee	30393	0.003	0.392	-2.381	-0.001	2.916
Absrem	30393	0.156	0.204	0	0.106	7.128
Size	30393	22.408	1.333	17.641	22.219	28.697
Lev	30393	0.436	0.207	0.008	0.426	1.957
Roa	30393	0.026	0.0970	-3.994	0.0320	0.786
Age	30393	2.334	0.702	0.693	2.398	3.526
Top1	30393	0.328	0.147	0.003	0.303	0.900
Audittype	30393	0.961	0.193	0	1	1
Big4	30393	0.060	0.238	0	0	1
Salary	30393	14.714	0.707	9.385	14.673	18.584
Boardsize	30393	8.400	1.662	0	9	18

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4.2 Baseline Regression Results

According to column (1) of Table 2, the coefficient of real earnings management is 0.048 and significantly positive at the 1% level. Therefore, real earnings management by enterprises has a significant positive effect on abnormal audit fees. Besides, Columns (2) and (3) show the regression results of real earnings management to positive and negative abnormal audit fees respectively. Column (2) shows that the coefficient of real earnings management to positive abnormal audit fees is 0.04, which is significantly positive at 1% level. Column (3) shows that real earnings management has no influence on negative abnormal audit fees. Therefore, real earnings management has a stronger promoting effect on positive abnormal audit fees, assuming H1 is validated.

Table 2: Baseline Regression Results

	(1) Abfee	(2) HiAbfee	(3) LoAbfee
Absrem	0.048***	0.040***	-0.009
	(0.011)	(0.007)	(0.006)
Controls	YES	YES	YES
_cons	-0.398***	-0.279***	0.119***
	(0.064)	(0.042)	(0.034)
IND	YES	YES	YES
YEAR	YES	YES	YES
N	30393	30393	30393
Adj-R^2	0.032	0.028	0.037

Notes: Standard errors in parentheses: * p < 0.1;** p < 0.05.;*** p < 0.01. The following text is the same.

4.3 Robustness Tests

4.3.1 Instrumental Variable Method

This paper uses lagged real earnings management data of firms as an instrumental variable to mitigate endogeneity issues. In the identification test, the P-value of the LM statistic for Kleibergen-Paap rk is 0.0000, rejecting the null hypothesis; the F-statistic value of Kleibergen-Paap Wald rk is greater than the 10% critical value of Stock-Yogo, passing the weak instrument test.

The test results are shown in Table 3: Column (1) demonstrates that in the first stage, the coefficient between L.Absrem and Absrem is significant at the 1% level, indicating a correlation between Instrumental variable and real earnings management. Column (2) demonstrates that in the second stage, the coefficient between real earnings management and abnormal audit fees is significantly positive at the 1% level, proving that Real earnings management will promote the increase of abnormal audit fees.

4.3.2 The Explanatory Variable is Lagged by One Period.

In this part, the explanatory variable is regressed by one period, and the regression results are shown in column (3) of Table 3, which proves the conclusion of benchmark regression again.

4.3.3 Replace the Explanatory Variable

This paper chooses the absolute value of the residuals (Absr) from the DD model constructed by Dechow and Dichev(2002) [18]to replace the explanatory variable. According to column (4) of Table 3, the coefficient of earnings management is significantly positive.

Table 3: Robustness Tests

	(1) first	(2) second	(3)	(4)
VARIABLES	Absrem	Abfee	Abfee	Abfee
L.Absrem	0.340***		0.043***	
	(0.027)		(0.012)	
Absrem		0.127***		
		(0.040)		
Absr				0.024***
				(0.009)
Controls	YES	YES	YES	YES
_cons			-0.463***	-0.421***
			(0.071)	(0.065)
IND	YES	YES	YES	YES
YEAR	YES	YES	YES	YES
N	25,357	25,357	25357	29885
Adj-R2			0.035	0.031

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4.4 Heterogeneity Analysis

4.4.1 Heterogeneity of Ownership Nature

Compared with non-state-owned enterprises that pursue profit maximization as the core, state-owned enterprises bear more social responsibilities and face stricter external supervision, so their motivation for earnings management is weakened, and the financial statements provided by enterprises are more true and reliable. Then, the audit risk of auditors is lower than that of non-state-owned enterprises, and the corresponding audit risk premium compensation is less, which has no obvious effect on the abnormal audit expenses of state-owned enterprises. Therefore, this paper speculates that the influence of real earnings management on abnormal audit fees is heterogeneous in ownership nature, and further divides the sample into two groups: state-owned enterprises and non-state-owned enterprises. According to the results of column (1) and column (2) in Table 4, column (1) shows that there is no significant correlation between the real earnings management of state-owned enterprises and abnormal audit fees. Column (2) shows that the coefficient of real earnings management in non-state-owned enterprises is 0.065, which is significantly positive at the level of 1%.

4.4.2 Heterogeneity of Enterprise Science and Technology Level

High-tech enterprises will strengthen their motivation for earnings management due to financing difficulties and capital market control policies (Wang et al., 2011)[19], and the concealment of earnings management will be further amplified by the professionalism of R&D activities and the complexity of accounting treatment. At this time, auditors will increase audit investment and increase risk premium compensation, and finally abnormal audit fees will rise. Therefore, this paper speculates that the influence of real earnings management on abnormal audit fees is heterogeneous in the level of science and technology of enterprises, and further divides the samples into two groups: high-tech enterprises and non-high-tech enterprises. According to the results of columns (3) and (4) in Table 4, it can be known that column (3) reflects that real earnings management will significantly promote the abnormal audit expenses of high-tech enterprises. Column (4) shows that there is no significant correlation between real earnings management and abnormal audit fees in non-high-tech enterprises.

Table 4: Heterogeneity Analysis

	(1) State-owned enterprises Abfee	(2) Non-state-owned enterprises Abfee	(3) high-tech enterprise Abfee	(4) Non-high-tech enterprises Abfee
Absrem	-0.033	0.065***	0.074***	0.020
	(0.030)	(0.011)	(0.014)	(0.020)
Controls	YES	YES	YES	YES
_cons	-1.640***	0.125	0.067	-0.846***
	(0.118)	(0.079)	(0.089)	(0.092)
IND	YES	YES	YES	YES
YEAR	YES	YES	YES	YES
N	10154	19496	15984	14409
Adj-R^2	0.044	0.045	0.033	0.038

5. Mechanism Analysis

5.1 The Mediating Role of Operational Risk

Columns (1) and (2) of Table 5 specifically show the results of operating risk as a mediating variable. Column (1) shows that the coefficient of real earnings management is significantly positive, indicating that real earnings management significantly increases operational risk. Column (2) tests the impact of real earnings management and operating risk on abnormal audit fees. The results show that the coefficient for operating risk is significantly positive, and the coefficient for real earnings management is also significantly positive. That is, enterprises engaging in real earnings management activities will increase operational risk, thereby promoting the increase in abnormal audit fees.

5.2 The Moderating Effect of Financing Constraints

Table 5 Column (3) shows the moderating effect of financing constraints. It can be seen that the

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interaction term coefficient (FCAB) between real earnings management and financing constraints is significantly positive at the 5% level, indicating that the direct effect of real earnings management on abnormal audit fees is moderated by financing constraints, meaning that financing constraints enhance the promoting effect of real earnings management on abnormal audit fees.

Table 5: Mechanism Analysis

	(1) OP_RISK	(2) Abfee	(3) Abfee
Absrem	0.039***	0.048***	0.052***
	(0.007)	(0.011)	(0.011)
OP_RISK		0.018**	
		(0.007)	
FCAb			0.115**
			(0.045)
FC			0.007
			(0.018)
Controls	YES	YES	YES
_cons	0.339***	-0.404***	-0.450***
	(0.095)	(0.064)	(0.103)
IND	YES	YES	YES
YEAR	YES	YES	YES
N	30393	30393	29890
Adj-R^2	0.009	0.033	0.032

6. Conclusions

This paper takes A-share listed enterprises in China from 2014 to 2023 as research samples to study the impact of real earnings management on abnormal audit fees. The results indicate that: first, real earnings management significantly increases abnormal audit fees for enterprises, with operational risk serving as a mediating factor. Secondly, this paper further explores the moderating effect of financing constraints, finding that financing constraints enhance the positive impact of real earnings management on abnormal audit fees. Finally, the heterogeneity analysis shows that in non-state-owned enterprises and high-tech companies, real earnings management has a more significant promoting effect on abnormal audit fees.

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