The Impact of Audit Quality on Earnings Management: Evidence from S&P Sri Lanka 20 Index Companies of the Colombo Stock Exchange

D. Ruwan Lakjeewa[1], M. A. Fathima Sheeba[1,*]

[1]Department of Business and Management Studies, Faculty of Communication and Business Studies, Trincomalee Campus, Eastern University, Sri Lanka

*sheebafma@gmail.com

Received: 12/02/2026
Revised: 28/04/2026
Accepted: 10/06/2026
Published: 15/07/2026

Abstract: Earnings Management involves manipulating reported income through various accounting practices and decisions. Numerous financial collapses have raised questions about the reliability of the audit function, as auditors play a critical role in expressing opinions on financial statements. This paper investigates the impact of audit quality on earnings management in Standard & Poor's SL 20 index companies. The objectives are to identify the relationship between audit quality and earnings management and to examine the impact of audit quality on earnings management. S&P SL 20 companies were selected using a purposive sampling technique, with data sourced from annual reports and audited financial statements for the period from 2012/2013 to 2021/2022. The findings reveal that audit quality significantly associated with the degree of earnings management in S&P SL 20 index companies, showing a significant impact with earnings management. All variables demonstrate an insignificant association with earnings smoothing. The findings are valuable for shareholders in the appointment and reappointment of auditors and enable stakeholders, including regulatory bodies, to assess earnings management practices in S&P SL top 20 companies on the Colombo Stock Exchange. This paper concludes that audit quality exerts significant impact on the degree of earnings management, likely due to effective monitoring mechanisms that incentivize auditors to enhance audit quality.

Keywords: *Audit Quality (AQ); Discretionary Accruals (DA); Earnings Management (EM); Modified Jones Model; Standard and Poor's Sri Lanka 20 (S&P SL20)*

1. Introduction

Financial Statements are used to reflect company's performance through financial information providing insight to both external and internal users. Users of financial statements or stakeholders of a company expect a better financial condition in a particular company that yields high profits its operations. Continually investor's decision making process greatly relies on the accounting information provided by the management which they have appointed to utilize the assets belonging to investors. Due to this great reliance on the financial information provided by management, it usually stimulates management to manipulate CSE earning through the financial statements, which are prepared by the management of a particular company. This opportunistic behavior of management leads for earnings management practices (Nisansala and Menike, 2018).

Financial statements are the most important source of information for investment decisions. The most significant variable in the financial statement that attracts attention is the earnings of the company. The earnings of a company are the residual income, which depicts the underlying financial performance of that company (Pakianathan, 2017).

Literature indicates that such investor trust is broken into pieces when earnings are managed to create a falsified picture than showing the reality (Pakianathan, 2017). EM is related to the manipulation of reported income through accounting practices and decisions. With the occurrence of numerous financial collapses and failures, those have been challenged to the reliability of the audit function, as auditors play a critical role in expressing an opinion on the financial statements. EM occurs mainly due to the

inconsistency between the interests of the shareholders and the management, which is described by the agency theory (Hettihewage et al., 2022).

Generally, agency problem arises due to asymmetric information on investment opportunities between owners and managers (Pakianathan, 2017). As a result, owners have less information to monitor and control the managers' activities. In this contractual situation, characterized by the conflict of interests between shareholders and managers, corporate governance employs different mechanisms that resolve the interests of shareholders and managers. Subsequently, proper corporate governance mechanisms are highlighted by several amendments of code of best practices – for example, combined code in the UK, Sarbanes–Oxley Act in the USA and Sri Lankan corporate governance code of best practices. However, there is a significant and ongoing argument in the corporate governance literature regarding the apparent relationship between ownership structure and managers' earning management practices (Kazemian and Sanusi, 2015).

Apart from the above, corporate accounting fraud is evidenced by the devastating high-profile corporate failures such as Enron, Tyco, WorldCom, and Satyam Computers that occurred around the globe (Kankanamage, 2015). Earnings of a company are the residual income, which reflects the underlying financial performance of that entity and is the most significant variable in the financial statements (Pakianathan, 2017). Even though accounting information such as earnings are considered important at present, Deegan (2014) points out that during the mid-1960s the usefulness of accounting information was highly questioned. Earnings calculated using historical cost based accounting was heavily opposed and radical changes to accounting were prescribed by several theorists and practitioners in order to make financial statement information more relevant for decision making (Pakianathan, 2017).

Cohen et al. (2008) highlighted that the behavior of earnings management was increasingly growing from 1987 till the enactment of Sarbanes-Oxley (SOX) Act in 2002. The severity of this agency problem heightened during the period between 1999 and 2002 when corporate scandals such as Enron, WorldCom, and Tyco occurred. Arens et al. (2010) describe the fall of Enron as one of the significant corporate collapses in American history. The fall was witnessed after the company recorded $618Mn quarterly loss, which after investigations was revealed due to the company claiming nearly $600Mn of falsified earnings from 1997. Thomas (2002) identifies the 360-degree employee review which forced company officials to record earnings to survive in the intense performance-driven culture of Enron, as the root cause for this fall. This along with the WorldCom scandal led to the pass of (SOX) Act in 2002. External auditing has also laid the foundation to eliminate agency costs and earnings management. Thus, it reveals that the audited financial statements are trustworthy, reliable, and accurate.

Despite all these control measures, EM can still occur. This can be proved by local corporate scandals including, Pramuka Bank, Touchwood Investments, Golden Key Credit PLC, Galadari Hotels Lanka Ltd, ETI Finance Ltd, Vanik Incorporation Ltd, Ceylinco Group, and the Finance Company PLC (Pakianathan, 2017; Wijedasa, 2013). The implementation of the SOX Act was an important milestone in global corporate governance practices. However, Cohen et al. (2008), who examined the impact of SOX Act on EM, revealed that though a significant decline was evident in accrual based EM after the passage of the SOX Act real EM practices had begun to increase significantly. The demise of the 164 years old company, Lehman Brothers in the post-SOX Act period can be described as a 'seminal event' in the 2008 global financial crisis. Lehman Brothers, which in 2007 was awarded the most admired securities firm by the Fortune magazine, was filed for bankruptcy protection in 2008 due to alleged manipulation of sales and assets through the use of re-purchase agreements (Wiggins et al., 2014).

With the conclusion of the thirty year conflict in 2009, Sri Lanka's CSE experienced unprecedented investor interest, with Bloomberg ranking CSE the best performing stock exchange for the year 2010. However, by June 2012, the investor confidence had eroded and an analysis of 78 stock exchanges conducted by Bespoke Investment Group identified CSE as the world's fourth worst performing stock exchange to date during that year.

1.1. Problem Statement

During last years, audit quality has become as most conferring topic which represents the earnings management of a particular firm, refers to how well reported earnings represent real company performance (Withana and Ajward, 2022). In last few decades it has been witnessed series of accounting scandals and corporate failures in worldwide due to the manipulation of the earnings by the management. Accounting scandals of Sunbeam, Cendant, WorldCom and ComRoad, Xerox which occurred globally and especially which were not detected by audit were caused to recrudesce the topic of earnings management in present (Nisansala and Menike, 2018). According to Wild (1996) it is needed a mechanism which can be restricted the opportunistic behavior of managers. In that case audit committee as well as external auditor plays a crucial role as independent parties of the firm by ensuring higher level of audit quality on mitigating earnings management practices (Velnampy et al., 2014).

Therefore, the problem of the study is that: *"Does the impact of audit quality on the degree of earnings management of S&P SL top 20 companies in Sri Lanka?"*

1.2. Research Gap

While numerous studies have investigated the relationship between audit quality and earnings management, there appears to be a research gap concerning the potential moderating effect of industry characteristics on this relationship, particularly in the context of Sri Lanka (Ruparatne, 2018). Industries vary in their complexity, competitive dynamics, regulatory environment, and inherent risks. These variations might influence the extent to which audit quality mitigates or exacerbates earnings management practices (Kankanamage, 2015).

Exploring the moderating role of industry characteristics can enhance our understanding of the nuanced relationship between audit quality and earnings management (Ruparatne, 2018). By focusing on Sri Lanka, where industry-specific dynamics and regulatory practices might differ from those in other countries, the paper could provide insights into how audit quality's effectiveness in curbing earnings management might vary across different sectors of the economy (Rajapaksha and Tilakasiri, 2020).

Furthermore, Anwar (2019) examined earnings management and ownership structure of listed firms at the Colombo Stock Exchange in Sri Lanka. Mightily, Velnampy et al. (2014) studied board leadership structure, audit committee and audit quality of manufacturing companies listed in Sri Lanka. Thumping, Withana and Ajward (2022) examined Impact of abnormal audit fees on earnings management practices of non-financial listed companies in Sri Lanka. Additionally, Rajapaksha and Tilakasiri (2020) studied the influence of corporate governance on earnings management in listed manufacturing companies in Sri Lanka. Moreover, Ruparatne (2018) examined corporate governance and earnings management: board characteristics of hotel and travels; beverage, food and tobacco; and manufacturing sectors in Sri Lankan perspective.

To fill the gap in this context, the current paper attempts to examine the impact of audit quality on the degree of earnings management of S&P SL 20 index companies in CSE in Sri Lanka using secondary data. Moreover, there is no prior research in Sri Lanka by analyze the impact of audit quality (Audit firm size, Audit independence, Audit Tenure, Auditor industry specialization, Audit committee financial expertise and Auditor's reputation) on the degree of earnings management of S&P SL 20 index companies. Therefore, it is an important to examine the impact for the Sri Lankan context on this research area. Over time, there may have been changes in audit quality and earnings management practices in Sri Lanka. By looking at previous studies, can assess how these trends have evolved and whether there have been significant developments in recent years.

The research gap can be addressed and contribute to the existing body of knowledge can be explained as follows: In terms of context-specific evidence, previous studies have mainly focused on developed countries, while evidence from developing economies such as Sri Lanka remains limited. This paper provides empirical evidence from Sri Lankan listed companies, helping to fill the geographical and

contextual gap in the literature. Regarding the examination of multiple audit quality dimensions, earlier research often examined only one proxy of audit quality (e.g., auditor size or auditor tenure). The current paper incorporates multiple indicators of audit quality, providing a more comprehensive assessment of its influence on earnings management. In terms of recent evidence, changes in corporate governance practices, auditing standards, and regulatory requirements may affect the relationship between audit quality and earnings management; this paper uses recent data, offering updated insights into the effectiveness of audit quality in reducing earnings manipulation. Furthermore, regarding industry-level insights, limited research has investigated whether the impact of audit quality differs across industries; the paper provides sector-specific evidence, enhancing understanding of variations in earnings management practices.

Contribution to the Existing Body of Knowledge: In terms of theoretical contribution, the paper strengthens agency theory by examining how high-quality audits act as a monitoring mechanism to reduce conflicts between managers and shareholders. Empirically, it adds new empirical evidence on the relationship between audit quality and earnings management, particularly in the Sri Lankan context. Methodologically, by using multiple measures of audit quality and earnings management, the paper offers a more robust analytical framework for future researchers. Practically, the findings can assist investors, auditors, regulators, and corporate boards in understanding the importance of audit quality in ensuring reliable financial reporting. From a policy perspective, the results may support policymakers and regulatory bodies in developing stronger auditing and corporate governance regulations to improve financial reporting quality. Overall, this paper addresses the existing research gap by providing updated, context-specific evidence on the relationship between audit quality and earnings management. It contributes to academic literature, enhances theoretical understanding, and offers practical and policy implications for improving financial reporting transparency and corporate governance.

1.3. Research Questions

Based on the research problem of the paper the following research questions are formulated:

1. What is the relationship between audit quality and the degree of earning management practices in the S&P SL 20 index companies in Sri Lanka?
2. What is the impact of audit quality on the degree of earnings management practices in the S&P SL top 20 index companies in Sri Lanka?

1.4. Research Objectives

As a result, the paper's specific seeks are as follows:

1. To identify the relationship between audit quality and the degree of earnings management practices in S&P SL 20 index companies in Sri Lanka.
2. To examine the impact of audit quality on the degree of earnings management practices in S&P SL 20 index companies in Sri Lanka.

2. Literature Review

2.1. Theoretical Review

Agency theory assumes that managers are motivated by their personal gains and work to exploit their personal interest and not the interest of the shareholders. Managers for instance may be interested in buying lavish offices, company cars and other extravagant items, since the cost of these items is not borne by them (managers) but the owners (shareholders). The main problem of agency theory is how to align the conflicting interests of the managers with the interests of shareholders. Consequently, when managers have incentives to manage earnings such as to meet or beat earnings target and performance

based compensation, they manipulate the company's reported earnings. This manipulation reduces the relevance and reliability of reported accounting earnings and financial statements generally (Pakianathan, 2017).

Positive accounting theory has diverse accounting practices applied to affecting the outcomes of firms where managers may assume two sorts of behavior. The first type is the opportunistic behavior, which refers to preferring one's interest at the rate of other stakeholders. The second type refers to the intended behavior of using accounting values professionally to make the most of the company's worth. The use of earnings management can be clarified by the following three elements: compensation, company size and debt (Watts and Zimmerman, 1986).

The stakeholder's theory of corporate governance developed by Edward Freeman in the 1980s. The stakeholder's theory argues that, a company should be managed in the interest of its entire stakeholder. The interest of the stakeholder include, the interest of the shareholders and other direct and indirect stakeholders such as, suppliers and creditors who have direct interest in the organization and supplies to the company on credit, based on their performance and investors who eventually invest their money in the company based on the audited report of the independent auditors and the host community (Freeman, 1984).

Information asymmetry theory, the state of information asymmetry occurs when one party in a relationship has more or better information than the other (Bergh et al., 2019). An information asymmetry in a company emerges as a consequence of managers having a competitive advantage in the company's information over the stakeholders. Managers at a company typically have greater access to insider information about the company's operations than stakeholders, which allows them to manipulate earnings.

2.2. Empirical Review

The accounting literature is yet to provide a universally accepted definition of the term "earnings management". Earnings Management (EM) is called by several names such as accounting numbers game (Comiskey and Mulford, 2002); creative accounting (Vladu et al., 2009); income smoothing (Tucker and Zarowin, 2006), and so on. The concept of EM is defined differently by various researchers, depending on how they perceive it. Healy and Wahlen (1999) associated EM with the altering of financial statements through the use of judgment in financial reporting and in structuring transactions to alter financial reports to either misleads some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers. According to Schipper (1989), EM involves "disclosure management" in the sense of a purposeful intervention in the external financial reporting process, with a view to obtain private gain for shareholders or managers. Fields et al. (2001) associated EM arises when managers exercise discretion over accounting numbers, with or without restrictions. The discretion is exercised to either maximize firm value (shareholders wealth) or to maximize the selfish interest of managers (opportunistic EM). The definition of Fields et al. (2001), unlike the first two definitions suggests that EM could either be within or outside Generally Accepted Accounting Principle (GAAP).

While administrators practice personal discretion in preparing financial reports and restructuring operations to mislead the shareholders regarding the true economic performance of the corporation and to affect the contractual results that depend on the accounting numbers mentioned in the financial reports, then EM occurs (Elyasiani and Wen, 2017). However, EM is exercised by some corporations in order to achieve a number of goals, such as reaching the level of prediction of previously announced profits, avoiding loss declaration, and achieving some advantages associated with exaggerating the company's profits (Suryanto, 2018). EM is utilized to mislead the interested parties about the efficiency of the performance of the corporation or to influence the contracts concluded according to the financial report (Park, 2017). Moratis and van Egmond (2018) indicates that EM is utilizing of management estimation in a company. Amongst the generally accepted accounting principles (GAAP) are options

like accounting, profit reporting, and real economic decisions to influence the mechanism in which they are based on in reversing the economic events through the use of one or more methods for measuring profits. Khan (2019) mentioned that this is due to the school of thought that these accountants belong to. Suprianto and Setiawan (2018) defined EM as beneficial manipulation of the accounting results with the aim of creating a different perception of the company's true performance. Also, Christina and Alexander (2019) showed that EM is taking calculated steps within commonly accepted accounting principles in order to make the declared profits identical to those desired. Similarly, Almahrog (2018) defined EM as management's attempt to influence the declared profits number in the short term in order to achieve self-interest.

Generally, EM involves different activities ranging from legitimate to outright fraudulent financial reporting. These activities can be broadly classified into four major types (Vander Bauwhede et al., 2003; Zhao et al., 2012). The first type of earnings management arises from the exploitation of flexibilities in GAAP, commonly called within-GAAP earnings management. GAAP allows flexibility to enable firms to prepare financial statements that reflect the underlying economic reality. However, some managers abuse these accounting flexibilities through earnings manipulation. Examples of flexibilities in GAAP include choosing between various inventory valuation techniques and depreciation methods. This type of earnings management is perceived by some scholars as legitimate and beneficial to shareholders particularly, when it is well disclosed in the financial statements. The second group of EM activities involves violation of accounting principles (GAAP). It is called "with-out GAAP" EM. EM of this nature involves outright management fraud and is mostly associated with firms that have exhausted flexibilities in accounting principles to manage earnings.

As discussed above, in the context of developed countries, EM has been studied extensively (Alves, 2012; Habbash, 2013; Spinos, 2013). However, in the case of like Sri Lanka, only a few studies have been carried out. Kankanamage (2015) found a significant relationship between board size, board composition, board financial expertise and board meetings and earnings management of the Sri Lankan listed firms. While, Wijesinghe and Kehelwalatenna (2017) reveal that there is no significant impact of EM on stock returns of listed manufacturing companies in Sri Lanka.

The above literature emphasizes that many researchers had observed that corporate governance attributes have a significant influence over earnings management practices. Therefore, the current study was focused on Audit Quality such as Audit Firm Size, Auditor Independence, Auditor Tenure, Auditor Industry Specialization, Audit Committee Financial Expertise and Auditor's Reputation which the researcher expected to create an impact on the level of earnings management practices of S&P SL 20 index companies in CSE.

Most of audit quality studies concentrated on variances in big firm auditors and non-big firm auditors. This is because a big-firm audit firm would have more incentives to discover management manipulation since companies may be further successfully controlled by big-firm auditors and they would forfeit if an audit fiasco arises (Vander Bauwhede et al., 2003; Rusmin, 2010; Watts and Zimmerman, 1986). Thus, big firm auditors will be more effective in reducing EM to preserve their good names and thus evade legal liability.

Many prior studies found that Big 4 audit firm potentially diminishes EM (Chen et al., 2005; Chung and Kallapur, 2003; Dimitropoulos et al., 2013; Francis and Wang, 2008; Lin and Hwang, 2010; Rusmin, 2010). In contrast, some other studies displayed a positive relationship between the two variables (Antle et al., 2006) while other studies did not reveal any significant association at all (Maijoor and Vanstraelen, 2006; Piot and Janin, 2007). Evidence from these studies strongly specified that Big 4 auditors produce additional efficient auditing more than non-Big 4, and in turn limits EM activities.

Auditor independency is one of the keystones of auditing process. High degree of auditor independence ensures better financial reporting process. If auditors are not independent, it is more likely that they will fail to produce high-quality audits. It is predominantly undisputed that high degree of auditor independence enhances the credibility of firms' financial statements (Antle, 1984). Regulatory agencies use mandatory auditor rotation to increase auditor independence. Mandatory auditor rotation is also

expected to bring a fresh look at the firm's financial statements. Davis et al. (2002) state that a long term auditor and client firm relationship has adverse impacts on auditor independence and enables the management of firms to engage more actively in earnings management.

The company is in need of high-quality audits to detect material misstatements in the financial statements. The determines the quality of the audit is the Audit Tenure or length of the assignment of auditors in a company. The longer the auditor in charge in a company could cause significant emotional relationship with the client, resulting in reduced owned and auditor independence will tend to side with the agent. Emotional relationship will lead to asymmetry of information between the agent and the principal, but it also increases profit management practices performed by the agent. The study was conducted by Dinuka & Zulaikha (2014), which states that the audit tenure has a positive effect on earnings management. Different studies conducted by Inaam, Khmoussi & Fatma (2012), who found that audit tenure has no effect on earnings management.

In addition to auditor size, this study also considers industry specialization auditors to be another proxy for audit quality (Krishnan, 2003). The rationale is that industry specialization auditors invest heavily in technologies, physical facilities, personnel, and organizational control systems that enable them to detect irregularities and misrepresentations more easily (Kanagaretnam et al., 2010).

According to Code of Best Practice on Corporate Governance, the board should ensure the availability within it of those with sufficient financial acumen and knowledge to offer guidance on matters of finance. Xie et al. (2003) have found that firms having committee members with financial expertise have lower discretionary current accruals. As an opposing view, according to a study carried out in Malaysia, has found that there is a positive relationship between financial expertise and earnings management. Directors with financial expertise can use their knowledge to commit frauds and they can window dress the financial statements easily as they are responsible for the preparation and presentation of financial reports based on this perspective.

The auditor's reputation is demonstrated by public trust in the auditor's performance. The auditors are responsible for public trust and bound in honor of the auditor and the Public Accounting Firm (PAF) where the auditors work by issuing opinions that are appropriate to the company state.

Companies that have used KAP services with Big Four's reputation usually will not do auditor switching because they consider that reputable KAPs are able to support the companies in maintaining its survival. Agency theory states that the relationship between agents and principals will lead to conflicts of interest. So as to maintain the continuity of cooperation between principals and managements and survival of the companies, monitoring tool is needed, that is a third party as an intermediary that can be used by the principal to see the performance of management.

3. Methodology

3.1. Conceptual Framework

The conceptual framework illustrates the relationship between the independent variables, moderating variables, control variables, and dependent variables examined in this research.

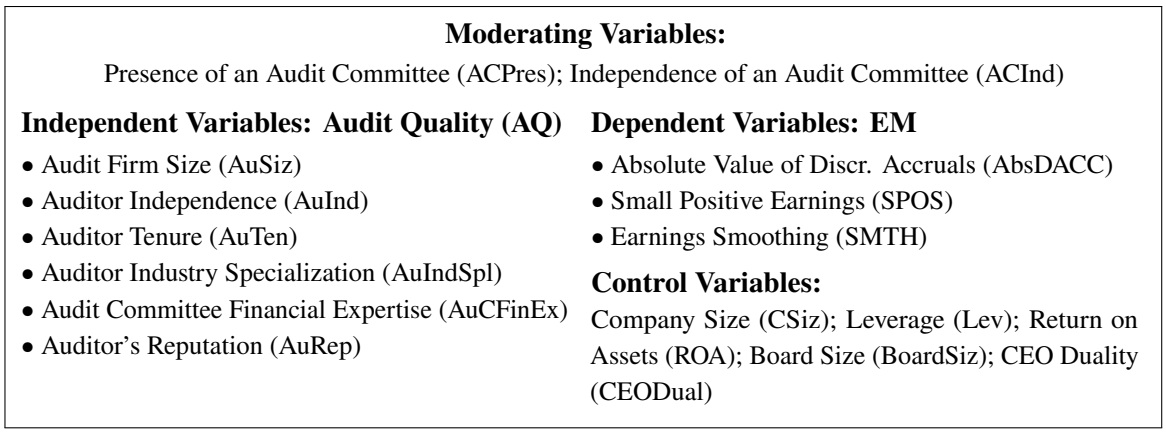


Figure 1: Conceptual Framework

Source: Constructed by Author (2023)

3.2. Operationalization

Table 1 displays the operationalization of variables employed in this research.

3.3. Research Design / Approach

The objectives of this paper are to access the relationship between audit quality and degree of EM and to assess the impact of audit quality on degree of EM. A quantitative approach within a positivistic paradigm is utilized, which is also used in similar extent studies (Pakianathan, 2017). The data used in the paper are secondary obtained from the published integrated annual reports of the sample companies, available on the CSE website. Finally, this research design is conducted in panel regression research.

3.4. Population & Sample

This paper examines the impact of audit quality on the EM of the S&P SL 20 index companies in Sri Lanka. The population of the paper is the listed companies in the CSE. As at 31st August 2023, 290 entities have been listed in the CSE. A sample is a subset of the population. Out of such a population, this paper focuses on the S&P SL top 20 companies on 17th June 2023. The data is collected from integrated annual reports, annual reports and audit reports for the financial periods 2012/2013 to 2021/2022 of S&P SL top 20 companies in the CSE.

3.5. Sampling Technique

This research has used purposive sampling technique to collect data. Because every element in the population has an equal chance of inclusion in the sample. This technique is most appropriate for conduct the research. This research is categorized as explanatory research, for it focuses on the disclosure of causal relationships between the variables. Purposive sampling was employed as the sampling method in which the researcher has determined certain characteristics to attain particular objectives before embarking on the research exploration.

Table 1: Operationalization of Variables

Dimension	Abbreviation	Indicator	Source
Dependent variables			
Absolute value of discretionary accruals	$AbsDACC_{it}$	Absolute values of discretionary accruals using modified Jones model	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)
Small positive earnings	$SPOS_{it}$	"1" if net income scaled by total assets is between 0 and 0.01 and "0" otherwise	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)
Earnings smoothing	$SMTH_{it}$	Absolute change in net income divided by change in cash flow from operations	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)
Independent variables			
Audit firm size	$AuSiz_{it}$	"1" if auditor is a member of Big four, "0" otherwise	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)
Audit Independence	$AuInd_{it}$	Natural logarithm of audit fees of company *i* for year *t*	(Pakianathan, 2017; Hettihewage et al., 2022)
Auditor Tenure	$AuTen_{it}$	Number of years the auditors has audited the firm's financial statements	(Pakianathan, 2017)
Auditor Industry Specialization	$AuIndSpl_{it}$	Dummy variable: 1 if industry market share of audit firm > 20%, 0 otherwise	(Pakianathan, 2017)
Audit Committee Financial Expertise	$AuCFinEx_{it}$	Dummy variable: 1 if majority of directors are financial experts, 0 otherwise	(Pakianathan, 2017)
Auditor's Reputation	$AuRep_{it}$	1 = KAP Big Four, 0 = KAP Non Big Four	(Pakianathan, 2017)
Moderating variables			
Presence of an Audit committee	$ACPres_{it}$	"1" if company has an audit committee, "0" otherwise	(Pakianathan, 2017; Hettihewage et al., 2022)
Independence of an Audit committee	$ACInd_{it}$	Ratio of Independent Non-executive committee members to total AC members	(Pakianathan, 2017; Hettihewage et al., 2022)
Control variables			
Company size	$CSiz_{it}$	Natural logarithm of Total assets of company *i* for year *t*	(Pakianathan, 2017; Hettihewage et al., 2022)
Leverage	Lev_{it-1}	Total Liability of company *i* for year *t* divided by Total assets for year $t-1$	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)
Return on Assets	ROA_{it}	EBIT of company *i* for year *t* divided by Total assets for year *t*	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)
Board size	$BoardSiz_{it}$	Total number of board members of company *i* for year *t*	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)
CEO Duality	$CEODual_{it}$	"1" if the roles of the CEO and chairman are combined and "0" otherwise	(Pakianathan, 2017; Hettihewage et al., 2022; Ruparatne, 2018)

Source: Constructed by Author (2023)

The criteria that must be met for a sample of this research are: firstly, S&P SL 20 index companies listed on the CSE during the period 2013 - 2022 and did not experience any delisting during the study period. Secondly, the companies publish audited financial statements for the period ending on 31st of March and December. Thirdly, data on variables of the study should be available in full in the financial statements and the company publishes financial statements in units of currency. Finally, from total population of 290 companies, the total sample that can be processed is 20 companies for 10 years (N = 200 firm-year observations).

4. Data Analysis & Results

Data presentation can be defined as the process of using various graphical formats to visually represent the relationships between two or more datasets so that an informed decision can be made based on them. Texts and tables are the most common and effective communication media that present and convey data and information as they aid readers in understanding the content of research, sustain interest, and effectively present large quantities of data.

4.1. Descriptive Statistics

Descriptive statistics are used to describe the main characteristics of independent, dependent, moderate and control variables used in this study. Also, it aims to summarize a sample rather than using data to learn about the population, which sample represents. The AQ and EM variables along with the moderating and control variables are analyzed using descriptive statistics to provide a general overview of the sample. The results of the analysis are shown in Table 2.

Table 2: Descriptive statistics of the variables (N = 200)

Variable	N	Minimum	Maximum	Mean	Std. Deviation
AuInd	200	9.3400	19.0900	16.4404	1.36935
AuIndSpl	200	0.0000	1.0000	0.3100	0.46200
AbsDAC	200	25,254,999.40	151,111,233,000.00	8,374,368,601.66	19,397,978,322.08
SPOS	200	0.0000	1.0000	0.2500	0.43400
SMTH	200	-53.5000	43.1800	1.3931	5.85571
ACInd	200	0.2500	0.8000	0.5032	0.14594
CSiz	200	17.5000	33.3700	25.1647	2.99531
Lev	200	0.0200	0.9300	0.6022	0.20417
ROA	200	-0.2100	0.7600	0.0768	0.12259
BoardSiz	200	5.0000	15.0000	9.0200	2.68900
CEODual	200	0.0000	1.0000	0.2500	0.43400

Source: SPSS Output Result (2023)

Table 2 summarizes the distributions of the variables used in the analysis. The auditor-independence proxy, measured as the natural logarithm of audit fees, had a mean of 16.4404, a standard deviation of 1.36935, and a range of 9.34 to 19.09.

Auditor tenure was ten years for every observation. The variable was omitted from subsequent tests because it did not vary within the sample.

4.2. Pearson's Correlation Analysis

Table 3 illustrates the correlation coefficient and significance of the independent variables, dependent variables, moderate variables and control variables discussed as follows:

Table 3: Correlation Matrix for Variables (N = 200)

Variables	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**	**(10)**	**(11)**
(1) AuInd	1.000	-.111	.236**	.088	-.045	-.196**	.179*	.289**	-.187**	.222**	.152*
(2) AuIndSpl	-.111	1.000	-.049	-.132	-.044	.132	.013	-.215**	-.026	-.056	.044
(3) AbsDACC	.236**	-.049	1.000	.013	-.052	-.168*	.147*	.287**	-.109	.210**	-.117
(4) SPOS	.088	-.132	.013	1.000	.117	-.169*	.352**	.485**	-.262**	.173*	-.120
(5) SMTH	-.045	-.044	-.052	.117	1.000	.032	.112	.123	-.117	.071	-.032
(6) ACInd	-.196**	.132	-.168*	-.169*	.032	1.000	-.081	-.365**	-.019	-.203**	.519**
(7) CSiz	.179*	.013	.147*	.352**	.112	-.081	1.000	.426**	-.245**	.110	-.012
(8) Lev	.289**	-.215**	.287**	.485**	.123	-.365**	.426**	1.000	-.305**	.208**	-.268**
(9) ROA	-.187**	-.026	-.109	-.262**	-.117	-.019	-.245**	-.305**	1.000	-.211**	-.115
(10) BoardSiz	.222**	-.056	.210**	.173*	.071	-.203**	.110	.208**	-.211**	1.000	-.107
(11) CEODual	.152*	.044	-.117	-.120	-.032	.519**	-.012	-.268**	-.115	-.107	1.000

** Correlation is significant at the 0.01 level (2-tailed). * Correlation is significant at the 0.05 level (2-tailed). Source: SPSS Output Results (2023)

Pearson's Correlation between auditor independence and absolute value of discretionary accruals was found to be weak positive and statistically significant ($r = 0.236$, $p = 0.001$, $p < 0.01$). This shows that there is a strong significant association between auditor independence and absolute value of discretionary accruals. Furthermore, increase in auditor independence would raise absolute value of discretionary accruals. Likewise, auditor independence and small positive earnings was found to be weak positive and statistically insignificant ($r = 0.088$, $p = 0.216$, $p > 0.05$). This shows that there is no significant association between auditor independence and small positive earnings.

The relationship between auditor independence and earnings smoothing was found to be weak negative and statistically insignificant ($r = -0.045$, $p = 0.528$, $p > 0.05$). This shows that there is no significant association between auditor independence and earnings smoothing. Like, auditor independence and independence of an audit committee was found to be weak negative and statistically significant ($r = -0.196$, $p = 0.006$, $p < 0.01$). This shows that there is a strong significant association between auditor independence and independence of an audit committee. Furthermore, increase in auditor independence would decrease the independence of an audit committee vice versa.

Pearson's Correlation between auditor industry specialization and small positive earnings was found to be weak negative and statistically insignificant ($r = -0.132$, $p = 0.063$, $p > 0.05$). This shows that there is no significant association between auditor industry specialization and small positive earnings. Like, auditor industry specialization and earnings smoothing was found to be weak negative and statistically insignificant ($r = -0.044$, $p = 0.533$, $p > 0.05$). This shows that there is no significant association between auditor industry specialization and earning smoothing.

Association between auditor industry specialization and independence of an audit committee was found to be weak positive and statistically insignificant ($r = 0.132$, $p = 0.062$, $p > 0.05$). This shows that there is no significant association between auditor industry specialization and independence of an audit committee. Likewise, auditor industry specialization and company size was found to be weak positive and statistically insignificant ($r = 0.013$, $p = 0.853$, $p > 0.05$). This shows that there is no significant association between auditor industry specialization and company size.

Likewise, absolute value of discretionary accruals and independence of an audit committee was found to be weak negative and statistically significant ($r = -0.168$, $p = 0.018$, $p < 0.05$). This shows that there is a moderate significant association between absolute value of discretionary accruals and independence of an audit committee. Furthermore, increase in absolute value of discretionary accruals would decrease the independence of an audit committee vice versa.

According to the correlation results obtained in Table 3, all variables are positively and negatively correlated with the other variables. Furthermore, these variables are statistically significant except some above variables and there is enough evidence to prove that the observed correlation exists in the population.

Table 4: Pearson's Correlation between Audit Quality and Earnings Management

		Earnings Management	**Audit Quality**
Earnings Management	Pearson Correlation	1	.215**
	Sig. (2-tailed)		.002
Audit Quality	Pearson Correlation	.215**	1
	Sig. (2-tailed)	.002	

** Correlation is significant at the 0.01 level (2-tailed). Source: SPSS Output Results (2023)

For correlation, look at the value of Pearson's correlation. Table 4 shows that the correlation coefficient (Pearson's correlation) of earnings management and audit quality is 0.215 and the p-value is 0.002. Correlation coefficient [r] indicates the weak positive relationship between the two variables (earnings management and audit quality). As the value of "r" is positive and the p-value is < 0.01, there is a strong significant positive correlation between audit quality and earnings management.

4.3. Multiple Regression Analysis (MRA)

Table 5: MRA for Absolute Value of Discretionary Accruals

Variable	**Prob.**
C	0.0195
AUDITOR INDEPENDENCE	0.0337
AUDITOR INDUSTRY SPECIALIZATION	0.7785
INDEPENDENCE OF AN AUDIT COMMITTEE	0.9779
COMPANY SIZE	0.7555
LEVERAGE	0.0365
RETURN ON ASSETS	0.9776
BOARD SIZE	0.0831
CEO DUALITY	0.3611
R-squared	0.130018
Adjusted R-squared	0.093579
Durbin-Watson stat	1.634746

Source: E-view Output Results (2023)

Here, Table 5 shows that the auditor independence probability fellow is 0.0337 which is less than 0.05. It means auditor independence determines absolute value of discretionary accruals in a good way. So, auditor independence is positive and statistically significant impact on absolute value of discretionary accruals for this regression model.

Then, comes to auditor industry specialization says the probability fellow is greater than 0.05. Which is 0.7785. Auditor industry specialization is positive and statistically an insignificant impact on absolute value of discretionary accruals for this regression model. It does not determine absolute value of discretionary accrual in a good way. And for the independence of an audit committee variable define the probability fellow is 0.9779 which is also greater than 0.05. Independence of an audit committee is negative and statistically an insignificant impact on absolute value of discretionary accruals for this regression model. It does not determine absolute value of discretionary accrual in a good way.

Similarly, company size probability fellow is 0.7555 which is greater than 0.05. Company size is positive and statistically an insignificant impact on absolute value of discretionary accruals for this regression model. It does not determine absolute value of discretionary accrual in a good way. Further, leverage probability fellow is 0.0365 which is less than 0.05. It means leverage determines absolute value of

discretionary accruals in a good way. So, leverage is positive and statistically significant impact on absolute value of discretionary accruals for this regression model.

And for the return on assets variable define the probability fellow is 0.9776 which is also greater than 0.05. Return on assets is positive and statistically insignificant impact on absolute value of discretionary accruals for this regression model. It does not determine absolute value of discretionary accrual in a good way. Moreover, board size probability fellow is 0.0831 which is greater than 0.05. Board size is positive and statistically an insignificant impact on absolute value of discretionary accruals for this regression model. It does not determine absolute value of discretionary accruals in a good way. And also, CEO duality variable define the probability fellow is 0.3611 which is also greater than 0.05. CEO duality is negative and statistically an insignificant impact on absolute value of discretionary accruals for this regression model. It does not determine absolute value of discretionary accrual in a good way.

Table 6: MRA for Small Positive Earnings

Variable	**Prob.**
C	0.4091
AUDITOR INDEPENDENCE	0.1562
AUDITOR INDUSTRY SPECIALIZATION	0.3334
INDEPENDENCE OF AN AUDIT COMMITTEE	0.7766
COMPANY SIZE	0.0119
LEVERAGE	< 0.0001
RETURN ON ASSETS	0.0996
BOARD SIZE	0.2998
CEO DUALITY	0.9489
R-squared	0.285367
Adjusted R-squared	0.255435
Durbin-Watson stat	1.390813

Source: E-view Output Results (2023)

Here, Table 6 shows that the auditor independence probability fellow is 0.1562 which is greater than 0.05. It means auditor independence determines small positive earnings in not a good way. So, auditor independence is negative and statistically an insignificant impact on small positive earnings for this regression model.

Then, comes to auditor industry specialization say the probability fellow is greater than 0.05. Which is 0.3334. Auditor industry specialization is negative and statistically an insignificant impact on small positive earnings for this regression model. It does not determine small positive earnings in a good way. And for the independence of an audit committee variable define the probability fellow is 0.7766 which is also greater than 0.05. Independence of an audit committee is negative and an insignificant impact on small positive earnings for this regression model. It does not determine small positive earnings in a good way.

Similarly, company size probability fellow is 0.0119 which is less than 0.05. Company size is positive and statistically significant impact on small positive earnings for this regression model. It determines small positive earnings in a good way. Leverage was positively associated with small positive earnings ($p < 0.0001$).

And for the return on assets variable define the probability fellow is 0.0996 which is also greater than 0.05. Return on assets is negative and statistically an insignificant impact on small positive earnings for this regression model. It does not determine small positive earnings in a good way. Moreover, board size probability fellow is 0.2998 which is greater than 0.05. It means board size does not determine small positive earnings in a good way. So, board size is positive and statistically an insignificant impact on small positive earnings for this regression model. And also, CEO duality variable define the probability

fellow is 0.9489 which is also greater than 0.05. CEO duality is positive and statistically an insignificant impact on small positive earnings for this regression model. It does not determine small positive earnings in a good way.

Table 7: MRA for Earning Smoothing

Variable	**Prob.**
C	0.9299
AUDITOR INDEPENDENCE	0.2377
AUDITOR INDUSTRY SPECIALIZATION	0.5532
INDEPENDENCE OF AN AUDIT COMMITTEE	0.3142
COMPANY SIZE	0.3938
LEVERAGE	0.2890
RETURN ON ASSETS	0.3105
BOARD SIZE	0.4317
CEO DUALITY	0.6726
R-squared	0.043624
Adjusted R-squared	0.003566
Durbin-Watson stat	1.878534

Source: E-view Output Results (2023)

Here, Table 7 shows that the auditor independence probability fellow is 0.2377 which is greater than 0.05. It means auditor independence does not determine earnings smoothing in a good way. So, auditor independence is negative and statistically an insignificant impact on earning smoothing for this regression model.

Then, comes to auditor industry specialization say the probability fellow is greater than 0.05. Which is 0.5532. Auditor industry specialization is negative and statistically an insignificant impact on earning smoothing for this regression model. It does not determine earnings smoothing in a good way. And for the independence of an audit committee variable define the probability fellow is 0.3142 which is also greater than 0.05. Independence of an audit committee is positive and statistically an insignificant impact on earning smoothing for this regression model. It does not determine earnings smoothing in a good way.

Similarly, company size probability fellow is 0.3938 which is greater than 0.05. Company size is positive and statistically an insignificant impact on earning smoothing for this regression model. It does not determine earnings smoothing in a good way. Further, leverage probability fellow is 0.2890 which is greater than 0.05. It means leverage does not determine earnings smoothing in a good way. So, leverage is positive and statistically an insignificant impact on earning smoothing for this regression model.

And for the return on assets variable define the probability fellow is 0.3105 which is also greater than 0.05. Return on assets is negative and statistically an insignificant impact on earning smoothing for this regression model. It does not determine earnings smoothing in a good way. Board size was not statistically significant in the earnings smoothing model ($p = 0.4317$). CEO duality was also statistically insignificant in this model ($p = 0.6726$).

Table 8: MRA for Audit Quality on the Earnings Management

Variable	**Prob.**
C	0.0058
AQ	0.0023
R-squared	0.045855
Adjusted R-squared	0.041036
Durbin-Watson stat	1.544442

Source: E-view Output Results (2023)

Here, Table 8 shows that the audit quality probability fellow is 0.0023 which is less than 0.05. It means audit quality determines the earnings management in a good way. So, audit quality is positive and statistically significant impact on earnings management for this regression model.

5. Conclusion & Recommendations

Focus on earnings management has increased considerably, since the fall of well-known corporates owing to scandals. Studies have been conducted to identify factors which induce or restrain earnings management practices and one such area which has received much attention is the impact of audit quality on earnings management.

The need for audit arises as a solution to the agency problem of conflicting interest.

Hence, quality of audit is paramount to monitor and restrain sub-optimal behaviour. However, studies investigating the said relationship have reported contradicting results. Furthermore, extensive studies have been conducted based on developed markets such as the US and the UK, while studies focusing on developing markets remain comparatively scarce. Thus, the broad objective and the theoretical significance of the study was to fill the gap by examining the impact of audit quality on earnings management in the context of Sri Lanka using information from public listed companies in the CSE.

In relation to the first objective, relationship between the audit quality and the degree of earnings management of S&P SL 20 companies. Based on these findings, this paper concludes that has significant association between the audit quality and the degree of earnings management in Sri Lankan S&P top 20 companies (Rusmin, 2010).

In relation to the second objective, it is clear based on the results that hypotheses of the paper are unsupported. Therefore, based on these findings, this paper concludes that audit quality has significant impact on the degree of earnings management in Sri Lankan S&P top 20 companies (Chung and Kallapur, 2003; Maijoor and Vanstraelen, 2006; Piot and Janin, 2007).

Researcher recommends that obtaining a larger sample for future studies as it can greatly increase the reliability of findings of the paper. Furthermore, the findings can only be generalized to the population of this paper only comprises of firms listed in CSE, future researchers can diversify into the firms not listed under CSE as there are many firms which is equally profitable but not listed. Therefore, the findings could be generalized to the greater population.

This paper only examined factors affecting audit quality and its implication on earnings management. Therefore, the further researches are expected to examine other variables that can also effect earnings management, such as: good governance mechanism, corporate governance, financial reporting standards and accounting information system. The further research is also expected to use qualitative methods to discover new factors that can affect the quality of earnings management. Future researchers can consider other methods to collect data such as interviews, observations etc. or combination of these methods as it can improve the findings of the paper significantly.

The results of this paper support the findings of previous research, which suggests that large and specialist audit firms act as an effective deterrent to earnings management because such firms not only have the competence to detect misstatements in financial reports but also the incentive to protect their reputation by reporting such misstatements. The findings offer important implications for users of financial statements, regulators, auditors and researchers. Financial statement users need to consider issues of audit quality in assessing the earnings quality of S&P SL 20, especially in environments with poor legal and institutional mechanisms for investor's protection.

Based on the findings of this paper, the following recommendations are suggested to different parties that are directly or indirectly involved in financial reporting process in Sri Lanka: A number of studies have investigated an impact of audit quality on earnings management. However, most of these studies were conducted in the developed countries. Very little is empirically known pertaining to the impact in emerging economies such Sri Lanka. The entire sample of companies considered in this paper had constituted audit quality (Audit firm size, Auditor independence, Auditor tenure, Auditor industry specialization, Audit committee financial expertise and Auditor's reputation).

Regulatory authorities in Sri Lanka such as Security Exchange Commission should come out with a policy that encourages audit firms in Sri Lanka to create departments within their firms that specialize along industry lines of companies listed in the CSE. This is necessary despite the fact that there are relatively few companies listed in the CSE and irrespective of auditor industry specialization is not associated with the degree of earnings management of sampled firms. Auditor industry specialization should be encouraged because the interaction between auditor independence and auditor industry specialization had an insignificant impact on earnings management of sampled firms in Sri Lanka. This is in view of the fact that corporate governance mechanisms do not work as substitutes but complement each other to effectively constrain earnings management of firms.

This paper recommends auditor tenure of ten years and below for external auditors of S&P SL 20 index companies in Sri Lanka. This reinforces SEC (2011) code of corporate governance which states that Sri Lankan S&P SL 20 companies can retain external auditors for a period of ten years consecutively, while disengaged auditors can only be reappointed after a period of ten years. Auditor tenure of at least ten years or less than ten would enable the auditor acquire client specific experience that could make him detect questionable financial reporting practices of the firm more easily than he was at the beginning of his audit engagement while an auditor tenure of more than ten years could deny the auditor firm specific experience, thus resulting to increase in earnings management of firms.

Audit committee with accounting and financial members should encourage their companies to hire industry specialist auditors. This is because good knowledge of the business environment by the auditor coupled with the accounting and financial experience of the audit committee members is likely to make each of them more effective in mitigating earnings management of firms especially in industries with complex business environment such as the S&P SL 20 companies.

The entire sample of companies considered in this paper had constituted an audit committee of the board (presence of an audit committee and independence of an audit committee) with a minimum of three directors. Audit committees with a larger number of members experience lower levels of earnings management. Large audit committees benefit from the diverse experience and skills of members and are able to do a more effective job in monitoring the financial reporting process (Pakianathan, 2017).

Almost all companies have a majority of independent audit committee directors. A wholly independent audit committee has no influence on earnings management. The analysis reveals that multiple directorships of audit committee members have the maximum impact on reducing earnings management. However, once majority of audit committee members become busy, the monitoring function suffers. This paper does not find any impact of having independence of an audit committee on the quantum of earnings management. Results also suggest that regulators should also encourage audit committee in firms to have qualities: a high proportion of the members possess audit committee, a high frequency of meeting to improve the monitoring function of the committee and a high proportion of independent non-executive committee members. Users of annual report information should also be informed that

these two characteristics of audit committee are important to achieve good governance that can reduce earnings management in firms (Pakianathan, 2017). Audit committee is compulsory for the sampled firms to have independent and financial expert audit committee. Additionally, this committee controlled the external auditor engagement to mitigate the earnings management.

Given audit quality is expected to play a progressively significant role in company value, policy makers and reformists may hearten companies to contract audit firms, particularly the Big 4 auditors. The results of current paper produced the following contributions. First, the findings identified that on average, audit quality affords effective monitoring of EM among S&P SL 20 index companies. Second, the findings were relevant for countries with comparable audit quality as Sri Lankan. Third, regulators and investors can correspondingly take advantage of the findings as they generate insight about the impact of audit quality on financial reporting quality (FRQ). The current paper added to the growing literature body on the relation between earnings management and corporate governance. From an applied view, this research offered information about audit quality on how FRQ can be improved and generated. The results increased the awareness of investors of the audit quality effectiveness in enhancing FRQ. Meanwhile, from the theoretical view, this paper assisted to provide support for the models of governance that comprise audit quality, since sturdy governance adds to FRQ.

Declarations

Funding: No external funding was received for this research.
Conflicts of interest: The authors declare no conflicts of interest.
Data availability: Data were obtained from published annual reports available on the Colombo Stock Exchange website.
Author contributions: D. Ruwan Lakjeewa and M. A. Fathima Sheeba contributed equally to conceptualization, methodology, econometric analysis, and manuscript preparation.

References

Almahrog, Y. A. (2018). Earnings management and corporate social responsibility: UK evidence. *Journal of Financial Reporting and Accounting*, 16(2):311–332.

Alves, S. (2012). Ownership structure and earnings management: Evidence from Portugal. *Australasian Accounting, Business and Finance Journal*, 6(1):57–74.

Antle, R. (1984). Auditor independence. *Journal of Accounting Research*, 22(1):1–20.

Antle, R., Gordon, E., Narayanamoorthy, G., and Zhou, L. (2006). The causes and consequences of audit fees: An analysis of Wages and risk premia. *Journal of Accounting Research*, 44(1):1–42.

Anwar, H. A. (2019). Earnings management and ownership structure: Evidence from Sri Lanka. *Working Paper, Colombo Stock Exchange*.

Arens, A. A., Elder, R. J., and Beasley, M. S. (2010). Auditing and assurance services: An integrated approach.

Bergh, D. D., Ketchen, D. J., Orlandi, I., Heugens, P. P., and Boyd, B. K. (2019). Information asymmetry in management research: Past accomplishments and future opportunities. *Journal of Management*, 45(1):122–158.

Chen, K. Y., Lin, K. L., and Zhou, J. (2005). Audit quality and earnings management for Taiwan IPO firms. *Managerial Auditing Journal*, 20(1):86–104.

Christina, S. and Alexander, N. (2019). Corporate governance, corporate social responsibility disclosure and earnings management. In *5th Annual International Conference on Accounting Research (AICAR 2018)*, pages 62–65. Atlantis Press.

Chung, H. and Kallapur, S. (2003). Client importance, nonaudit services, and abnormal accruals. *The Accounting Review*, 78(4):931–955.

Cohen, D. A., Dey, A., and Lys, T. Z. (2008). Real and accrual-based earnings management in the pre-and post-Sarbanes-Oxley periods. *The Accounting Review*, 83(3):757–787.

Comiskey, E. A. and Mulford, C. W. (2002). *The Financial Numbers Game: Detecting Creative Accounting Practices*. John Wiley & Sons, Hoboken, NJ.

Davis, L. R., Soo, B. S., and Trompeter, G. M. (2002). Auditor tenure and the ability to meet or beat earnings forecasts. *Contemporary Accounting Research*, 26(2):517–548.

Deegan, C. (2014). *Financial Accounting Theory*. McGraw-Hill, North Ryde, Australia, 4th edition.

Dimitropoulos, P. E., Asteriou, D., Kousenidis, D., and Leventis, S. (2013). The impact of IFRS on accounting quality: Evidence from Greece. *Advances in Accounting*, 29(1):108–123.

Elyasiani, E. and Wen, Y. (2017). Institutional ownership and earning management by bank holding companies. *Journal of Financial Research*, 40(2):147–178.

Fields, T. L., Lys, T. Z., and Vincent, L. (2001). Empirical research on accounting choice. *Journal of Accounting and Economics*, 31(1–3):255–307.

Francis, J. R. and Wang, D. (2008). The joint effect of investor protection and Big 4 audits on earnings quality around the world. *Contemporary Accounting Research*, 25(1):157–191.

Freeman, R. E. (1984). Strategic management: A stakeholder approach.

Habbash, M. (2013). Earnings management, audit committee effectiveness and the role of blockholders ownership: Evidence from UK large firms. *International Journal of Business Governance and Ethics*, 8(2):155–180.

Healy, P. M. and Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting Horizons*, 13(4):365–383.

Hettihewage, L. W. W. L. A., Wijekoon, W. M. H. N., Lakshan, A. M. I., and Perera, W. M. H. N. (2022). Impact of corporate governance and audit quality on the earnings management: Evidence from Sri Lanka. In *CMA National Management Accounting Conference Proceedings*, pages 1–18.

Kanagaretnam, K., Lim, C. Y., and Lobo, G. J. (2010). Auditor reputation and earnings management: International evidence from the banking industry. *Journal of Banking & Finance*, 34(10):2318–2327.

Kankanamage, C. A. (2015). The relationship between board characteristics and earnings management: Evidence from Sri Lankan listed companies. *Kelaniya Journal of Management*, 4(2):36–43.

Kazemian, S. and Sanusi, Z. M. (2015). Earnings management and ownership structure. *Procedia Economics and Finance*, 31:618–624.

Khan, Y. G. (2019). Earnings management in the presence of corporate governance quality: Evidence from the UAE (2007–2011). *International Journal of Mechanical and Production Engineering Research and Development*, 9:480–496.

Krishnan, G. V. (2003). Does Big 6 auditor industry expertise constrain earnings management? *Accounting Horizons*, 17:1–16.

Lin, J. W. and Hwang, M. I. (2010). Audit quality, corporate governance, and earnings management: A meta-analysis. *International Journal of Auditing*, 14(1):57–77.

Maijoor, S. J. and Vanstraelen, A. (2006). Earnings management within Europe: The effects of member state audit environment, audit firm quality and international capital markets. *Accounting and Business Research*, 36(1):33–52.

Moratis, L. and van Egmond, M. (2018). Concealing social responsibility? investigating the relationship between CSR, earnings management and the effect of industry through quantitative analysis. *International Journal of Corporate Social Responsibility*, 3(1):1–13.

Nisansala, K. and Menike, L. (2018). Audit quality, earnings management and financial performance: Evidence from Colombo Stock Exchange. *Journal of Accountancy and Finance*, 7:45–62.

Pakianathan, A. (2017). *Audit Quality and Its Impact on the Degree of Earnings Management: Evidence from Sri Lanka*. PhD thesis, University of Sri Jayewardenepura, Nugegoda, Sri Lanka.

Park, K. (2017). Pay disparities within top management teams and earning management. *Journal of Accounting and Public Policy*, 36(1):59–81.

Piot, C. and Janin, R. (2007). External auditors, audit committees and earnings management in France. *European Accounting Review*, 16(2):429–454.

Rajapaksha, R. A. and Tilakasiri, K. K. (2020). The influence of corporate governance on earnings management in listed manufacturing companies in Sri Lanka. *International Journal of Accounting and Financial Reporting*, 11(3):8–10.

Ruparatne, C. H. (2018). Corporate governance and earnings management: Board characteristics in a Sri Lankan perspective. *Field of Accounting Research*, 5:1–25.

Rusmin, R. (2010). Auditor quality and earnings management: Unconditional accruals. *International Journal of Economics and Finance*, 2(1):17–27.

Schipper, K. (1989). Commentary on earnings management. *Accounting Horizons*, 3(4):91–102.

Spinos, E. (2013). Managerial ownership and earnings management in times of financial crisis: Evidence from the USA. Master's thesis, Erasmus School of Economics, Erasmus University.

Suprianto, E. and Setiawan, D. (2018). Impact of family control on the relationship between earning management and future performance in Indonesia. *Business and Economic Horizons*, 14(2):342–354.

Suryanto, T. (2018). The corporate decision in Indonesia: A result of corporate governance requirements, earning management and audit reports. In *Governance and Regulations' Contemporary Issues*, volume 99, pages 183–206. Emerald Publishing Limited.

Thomas, C. W. (2002). The rise and fall of Enron. *Journal of Accountancy*, 193(4):41–48.

Tucker, J. W. and Zarowin, P. A. (2006). Does income smoothing improve earnings informativeness? *The Accounting Review*, 81(1):251–270.

Vander Bauwhede, H., Willekens, M., and Gaeremynck, A. (2003). Audit firm size, public ownership, and firms' discretionary accruals management. *The International Journal of Accounting*, 38(1):1–22.

Velnampy, T., Nimalthasan, P., and Kalaiarasi, K. (2014). Board leadership structure, audit committee and audit quality: Evidence from manufacturing companies in Sri Lanka. *International Journal of Business and Management*, 9(4):76–87.

Vladu, A. B., Amat, O., and Cuzdriorean, D. D. (2009). A brief review of creative accounting literature and its consequences in practice. *Annales Universitatis Apulensis: Series Oeconomica*, 11(1):170–182.

Watts, R. L. and Zimmerman, J. L. (1986). *Positive Accounting Theory*. Prentice-Hall, Englewood Cliffs, NJ.

Wiggins, R. Z., Piontek, T., and Metrick, A. (2014). The Lehman Brothers bankruptcy A: Overview. Technical report, Yale Program on Financial Stability.

Wijedasa, N. (2013). Depositors trapped in double game. The Sunday Times, September 15.

Wijesinghe, M. R. and Kehelwalatenna, S. (2017). The impact of earnings quality on the stock returns of listed manufacturing companies in the Colombo Stock Exchange. *Colombo Business Journal*, 8(2):68–89.

Withana, W. P. N. and Ajward, R. (2022). Impact of abnormal audit fees on earnings management practices: Evidence from non-financial listed companies in Sri Lanka. *Asian Journal of Accounting Research*, 7(3):312–326.

Xie, B., Davidson, W. N., and DaDalt, P. J. (2003). Earnings management and corporate governance: The role of the board and the audit committee. *Journal of Corporate Finance*, 9(3):295–316.

Zhao, Y., Chen, K. H., Zhang, Y., and Davis, M. (2012). Takeover protection and managerial myopia: Evidence from real earnings management. *Journal of Accounting and Public Policy*, 31(1):109–135.

Appendix 1: Companies included in the sample

The list is complete and up-to-date as of June 17, 2023.

Table 9: Constituent Blue-Chip Companies of S&P Sri Lanka 20 Sample

No	Company Name	Symbol
01	Browns Investment PLC	CSE:BIL.N0000
02	Chevron Lubricants Lanka PLC	CSE:LLUB.N0000
03	CIC Holdings PLC	CSE:CIC.N0000
04	Commercial Bank of Ceylon PLC	CSE:COMB.N0000
05	Dipped Products PLC	CSE:DIPD.N0000
06	Expolanka Holdings PLC	CSE:EXPO.N0000
07	Hayleys PLC	CSE:HAYL.N0000
08	Hatton National Bank PLC	CSE:HNB.N0000
09	Hemas Holdings PLC	CSE:HHL.N0000
10	John Keells Holdings PLC	CSE:JKH.N0000
11	Lanka IOC PLC	CSE:LIOC.N0000
12	LOLC Finance PLC	CSE:LOFC.N0000
13	LOLC Holdings PLC	CSE:LOLC.N0000
14	Melstacorp PLC	CSE:MELS.N0000
15	Richard Pieris & Company PLC	CSE:RICH.N0000
16	Royal Ceramics Lanka PLC	CSE:RCL.N0000
17	Sampath Bank PLC	CSE:SAMP.N0000
18	Softlogic Life Insurance PLC	CSE:AAIC.N0000
19	Sri Lanka Telecom PLC	CSE:SLTL.N0000
20	Vallibel One PLC	CSE:VONE.N0000