



## THE IMPACT OF BOARD SIZE AND AUDIT COMMITTEE CHARACTERISTICS ON FIRM'S FINANCIAL PERFORMANCE: EVIDENCE FROM LICENSED COMMERCIAL BANKS IN SRI LANKA

Oshadhi De Silva<sup>1</sup> and Yashodha Madhavi Hewage<sup>2\*</sup>

<sup>1</sup>Faculty of Management and Finance, University of Colombo Sri Lanka.

E-mail: oshadhidil572@gmail.com

<sup>2</sup>Faculty of Management and Finance, University of Colombo Sri Lanka.

E-mail: ym.hewage@gmail.com

\*Corresponding Author

Received: 2 November 2021; Revised: 24 November 2021;

Accepted: 10 December 2021; Published: 20 April, 2022

---

### ABSTRACT

The concept of Corporate Governance (CG) has become a contemporary focus in both accounting and finance arenas which plays a vital role, especially in the process of assuring financial reporting. Similarly, inconsistent results were found in the literature in relation to the impact of CG characteristics and firm performance (FP). Regardless of the fact that many studies are available on CG, it could notice that there is a dearth of evidence especially relating to the banking industry in the Sri Lankan context. Hence, the purpose of this study is to investigate the impact of board size (BS) and audit committee (AC) characteristics, namely AC size, AC meeting frequency, and AC expertise which can be treated as integral components of CG on the FP using the evidence of Licensed Commercial Banks (LCB) in Sri Lanka. The study was carried out using secondary data obtained through published annual reports of 24 LCB, including 96 observations in the Colombo Stock Exchange (CSE) from 2016 to 2019. The findings demonstrated BS have a significantly negative relationship with FP measured by both Return on Assets (ROA) and Return on Equity (ROE). Further, the findings related to AC suggest that the AC size and AC meeting frequency has an insignificant relationship with FP measured by both ROA and ROE. However, AC expertise depicted a significant positive relationship with FP measured by ROE while insignificantly related with ROA. Overall, this analysis highlights the importance of CG mechanisms which may be useful for policymakers for future designs. Further, the findings of the study would be helpful for management to make appropriate decisions regarding optimizing the board size and AC characteristics in order to safeguard the interests and demands of the different stakeholders of the firms.

**Keywords:** Board Size (BS), Audit Committee (AC), Audit committee characteristics, Firm Performance (FCB), Licensed Commercial Banks in Sri Lanka (LCB)

## 1. INTRODUCTION

Developing effective governance systems for the economy is a key goal in organizational progress, as it lowers the likelihood of financial crises and management disputes (Gompers *et al.*, 2003). CG acts as a portal for the assistance of relationships between corporate employees, owners, and other stakeholders. It has a crucial influence on the economy as it provides an assurance to the returns of the investors by lowering the related investment risk and hence, facilitates the companies' performance (Shleifer & Vishny, 1997). The Board of Directors (BOD) are one of the important monitoring mechanism for corporate control. The BOD's main purpose is to increase the company's financial position and non-financial position. Therefore, the size of the BOD can be considered as a critical factor when determining the firm financial performance (Jensen, 1993). The size of the BOD is highly debatable on CG. Further, when reviewing CG literature regarding BS and FP, it indicates conflicting results (Palaniappan, 2017).

The concept of AC differs according to the goals, functions, and responsibilities assigned to them. Al-Thuneibat (2006) defined it as the committee that is composed of non-executive directors in the establishment, whereas Arens *et al.* (2009) defined it as a group of persons selected from members of the BOD who are responsible for retaining the independence of the auditor.

Overall, AC is to provide oversight of the financial reporting process, the audit process, the company's system of internal controls, and compliance with laws and regulations. The recent crises caused mainly by the presence of illegal political funding, the exposure of suspicious financial transactions, and the multiplication of fraud cases have had a significant influence on the work and characteristics of the AC (Eichenseher & Schields, 1985). Thus, the attention towards the role of AC has developed in recent years as it is the key mechanism of CG that intends to boost the management board's interrogation (Hamdan & Mushtaha, 2011). Where it has been suggested that knowledgeable AC helps to improve the output of the company, and therefore, excellent AC features are correlated with excellent company performance (Zabri *et al.*, 2016).

Considering the legal context of CG in Sri Lanka, all the LCB need to adhere to CG requirements. In Sri Lanka, CG was introduced to the banking sector by the Central Bank of Sri Lanka (CBSL) in 2002. This was initiated as a voluntary code of CG, and in 2007, mandatory CG requirements were issued by the CBSL. The directions of the Banking Act and the Monetary Law Act in

Sri Lanka empower the CG. Institute of Chartered Accountants of Sri Lanka (CASL) and Securities and Exchange Commission of Sri Lanka (SEC) are pioneers in developing CG in Sri Lanka.

Even though there are past studies that have broadly investigated the audit function, they have not been considerably investigated the main AC characteristics (size of the AC, meeting frequency of auditors, and audit expertise) and its significance and effectiveness, especially in relation to the banking sector in Sri Lanka. Similarly, inconsistencies in the results were found in relation to the different proxies with FP under different settings. Hence, investigation of the impact of BS and AC characteristics on a firm's financial performance is vital. Furthermore, this is essential as less evidence was found relating to the Sri Lankan context, especially in the banking sector, to fill the gaps in the literature. Ultimately, this study contributes to CG literature by providing valuable insight to enhance the role and effectiveness of the AC in the Sri Lankan banking sector. Consequently, the findings of this study would be influential for the policymakers in designing a connected set of governance tools in a developing market context.

## **2. LITERATURE REVIEW**

### **2.1. Understanding the concept of CG**

There is no single definition of CG that can be applied to all situations and jurisdictions. Nevertheless, there are some commonly accepted definitions. The most widely used is "the system by which companies are directed and controlled" (Cadbury Committee, 1992). According to Weerasinghe and Ajward (2017), CG is an umbrella term that contains specific issues regarding the governance of the firm, arising from the interactions between shareholders, BOD, senior management, and other stakeholders. Although the CG has been exhaustively defined as a mechanism for controlling, leading, and investigating the activities of the firm by promoting corporate fairness, transparency, and accountability with the aim of creating shareholders' wealth, for the purpose of this study, it would be emphasized on the wider definitions that embrace a set of policies, structures, customs, laws, and procedures which define the controlling and administering of owner's resources (Onuorah *et al.*, 2016). Further, Paulinus *et al.* (2017) suggested that the CG structure, which combines internal as well as external mechanisms, leads the organization towards its ultimate objectives while also achieving its stakeholders' interests. Alzoubi (2014) has identified the BODs as the key powerful control factor of any organization for scrutinizing the

management activities, where the shareholders invest for getting them to pursue their interests fairly. Such investments are evident in the structure of the board, CEO duality, quality of the audit committee, executive compensation, and director's shareholding, etc.

When considering the CG in the Sri Lankan context, it has become significant during the last two decades due to happening some isolated incidents of corporate failures, certain economic reforms, and a series of recent scandals (i.e. Pramuka Bank, Vanik Corporation, Trading suspension of Entrust PLC, and Swarnamhal Finance PLC) in Sri Lanka. The first Sri Lanka code of best practices on CG was introduced in 1997 by the Institute of Chartered Accountants of Sri Lanka (CASL) to deal with Sri Lankan listed companies. It was based on the Anglo-Saxon model of CG and was a blueprint of Cadbury's code (1992). The 1997 code was replaced by CASL code of best practices which was introduced in March 2003 based on the Hampel report (1998). During the year 2008, the standards of CG were introduced into the CSE listing rules and made as mandatory compliance for listed companies in Sri Lanka by developing a joint initiative of CASL and SEC (Colombo stock exchange, 2008). Subsequently, certain revisions for the code of CG best practices have been made by CASL and SEC over a period in order to incorporate with recent global developments (Senarathne & Goonerathne, 2008; Weerasinghe *et al.*, 2017).

Accordingly, the Sri Lankan listed companies are now dealt with a comprehensive model of CG, which represents a mixture of both mandatory (companies act 2007, CSE listing rules, SEC directives and codes, CBSL directives for banks and financing companies) and voluntary (code of best practices of CG – CASL 2017) rules of CG. Hence, all listed banks are bound to comply with CG requirements.

## **2.2. Role of Board of Directors (BOD) and Audit Committee (AC) in CG**

The duty of BOD is to protect the rights and interests of the shareholders, and ultimately it becomes a monitoring mechanism as they assess the activities of the executives' and replace them when their performance is not satisfying the interest of the shareholders (Al-Farooque *et al.*, 2019). Therefore, BOD is the strategic decision-makers of the company. According to Topal and Dogan (2014), BOD tries to maximize the market value and FP through their decisions. The primary role of BOD is to reinforce the CG by implementing important roles of monitoring and advising on the allocation of resources (Ntim, 2015).

Consequently, it is stated that the efficient board functioning boosts the quality of financial reporting, which is indicated by decreased levels of earnings management activities (Safari, 2017). As reported by Jensen (1993), components such as BS, structure, and culture of the BOD make an essential contribution to the organization's success or failure. Accordingly, the BS that enhance the effectiveness of the board's monitoring role and minimizes the agency problem is a significant matter that has been subjected to ongoing study and investigation.

When considering the AC, it tries to develop the quality of the internal audit function by detecting and preventing frauds in the organization. As per the agency theory, AC has a crucial role in actualizing the standards of CG, and enhancing the value of the firm. Prior literature has shown that the effectiveness of AC can be measured through characteristics such as AC size, expertise and meeting frequency (Kusnadi *et al.*, 2016). Consistently, the agency theory also indicates that the AC involves in a significant role in implementing the CG principles and enhancing the firm value. Thus, the attention towards the role of AC has developed in recent years as it is the key mechanism of CG that intends to boost the management board's interrogation (Hamdan & Mushtaha, 2011). A proper AC, therefore, emphasizes enhancing the efficiency and competitiveness of the company, especially in an evolving business setting that is beyond the control of the company (Herdjiono & Sari, 2017).

### **2.3. Concept of Financial Performance**

Financial performance can be defined as the degree to which a business is carried out over a period of fixed duration of time which communicates about the general benefits and losses. It is calculated using the organization's assets, values, and obligations. Similarly, it refers to the financial strength of the entity and represents the performance of the managerial leadership of the organization (Matar & Eneizan, 2018). According to Heremans (2007), it depicts financial performance as the use of financial indicators to determine the degree of achievement of the goals, contribution to the allocation of accessible economic resources, and the assistance to the banks with investment opportunities. Managers can communicate their thoughts on the implications of business procedures and the destination's financial conditions by evaluating the money and carrying out the business (Ali, 2014). The competence of an organization also has an impact on its financial performance. Return on Investment (ROI), sales growth, earning per share (EPS), dividend yield, and market capitalization are all used to assess financial performance (Tudose, 2012).

The study of Santos and Brito (2012) on the investigation of the subjective measurement models for FP, it showed that FP has limited by conceptualization. Further, it was identified five dimensions of FP as financial performance, customer satisfaction, employee satisfaction, social performance, and environmental performance. Moreover, the study has considered ROA and ROE as the measurements of financial performance. Despite the emergence of more complex techniques such as Internal Rate of Return (IRR), Cash Flow Return on Investment (CFROI) that have come along, ROE has proven as a reliable method. It emphasizes a return to the shareholders of the organization, but on the other hand, it has the ability to obscure a lot of potential issues. Organizations can employ financial strategies to artificially manage a healthy ROE and thereby conceal deteriorating performance in the business. On the other hand, ROA prevents the possible distortions caused by misleading financial strategies (Zábojníková, 2016). Therefore, by considering these insights from empirical literature, the researcher has used both ROA and ROE as the indicators of financial performance to examine the impact of board size and AC attributes on the financial performance of LCB in Sri Lanka.

#### **2.4. Theoretical background**

The concept of CG originated with multiple theories. The two most pertinent grand theories considered explaining the agency conflicts and the need for CG are Agency theory, and the Stakeholder theory can be viewed as two main theories amongst many other applicable theories such as Resource dependence theory and Stewardship theory. Agency theory is the predominant theory since it is considered to be given birth to the concept of CG. However, all of them can be treated as different lenses to see the concept of CG from different and interesting angles. The particular angle or the perspective of CG from which looking at will decide the appropriateness of a more suitable theory.

Agency Theory was defined in two aspects as, the economic perspective (Ross, 1973) and the institutional perspective (Mitnick, 1973). Costs associated with the lack of goal congruence between two parties were brought to the fore by Ross (1973) and were further explored by Jensen & Meckling (1976). The separation of ownership and management provides the opportunity for management (agents) to act in their own self-interest by maximizing their own wealth and power at the expense of the owners (principals) (Fama, 1980; Jensen & Meckling, 1976). Since this relationship is not harmonious, indeed, so-called agency conflicts or conflicts of interest between agents and principals arise.

This is known as the “Agency Problem”. Hence, the companies try to limit this agency problem through a solid and effective CG policy such as including independent non-executive directors to the board, forming an AC to ensure fair management, and establishing two separate positions for CEO and chairman (Uwuigbe *et al.*, 2018; Weerasinghe *et al.*, 2017). Thus, such kind of adequate control mechanisms should be established along with good CG in order to direct the behavior of the managers and to compel them to act in the best interests of the shareholders.

Considering the stakeholder theory, which was founded by Freeman, it emphasizes different stakeholder groups of a corporation and recommendations on how the management should serve the interests of all those parties. This theory suggests that the companies have a social responsibility to restructure the CG framework, apart from the owner-manager relationship, and identify each set of interest groups (Paulinus *et al.*, 2017). In stakeholder theory, the principal-agent problem has been further widened because of concerning the interests of multiple principals as central to the sustainability of the business firm. Compared with the agency theory, this theory demonstrates CG in a holistic view, as a control mechanism created for efficient operations of a firm (Manawaduge, 2012). According to Weerasinghe *et al.* (2017), CG best practices, as the stakeholder theory point of view, should protect the interests of broad stakeholders and not only shareholders.

Resource dependence theory views a firm as an open system, dependent upon external organizations and environmental contingencies (Pfeffer & Salancik, 1978). Corporate boards are viewed as a means to manage external dependency (Pfeffer & Salancik, 1978), reduce environmental uncertainty (Pfeffer, 1972), and reduce transaction costs associated with environmental interdependency (Williamson, 1984) in linking the organization with its external environment. Hence, the board is considered as a part of both the organization and its environment. Relating to BS, this theory postulates that large boards would lead to superior business results due to diverse abilities, knowledge, and experiences that contribute to the board discussions. Further, large boards could also give the variety that would support organizations to acquire critical resources and mitigate environmental risks (Dakhlallah *et al.*, 2020). This is due to the fact that when the board becomes larger, it would also increase the availability of limited resources for the firm due to connections with the people belonging to the same or different industries (Kalsie & Shrivastav, 2016).

Stewardship Theory presents a contrasting view to Agency theory, which is ‘managers are essentially trustworthy individuals and therefore good stewards of the resources entrusted to them (Donaldson & Davis, 1991, 1994; Donaldson, 1990). Donaldson and Davis (1991) state that ‘managers are principally motivated by achievement and responsibility needs’ and once they are given the responsibility, self-directed work, organizations may be better served to free-managers, under non-executive director dominated boards. Further, this theory proposes that having a majority of executive directors on the committee would enhance the effectiveness and yield excellent outcomes than a committee consisting of a majority of independent directors (Al Mamun *et al.*, 2013). This can be mainly due to the technical expertise and knowledge of the executive directors about the firm and industry (Ntim, 2009).

### **2.5. Empirical evidence on Board size and firm financial performance**

The size of the BOD and its influence on FP can be considered as one of the most argued concerns in CG (Isik & Ince, 2016). When reviewing the previous studies, some studies have proven that there is a positive relationship, while some proved it as a negative relationship. Larger boards are often considered to be more experienced in monitoring the actions of top management as it is more difficult for CEOs to dominate the boards with large people (Mak & Rousch, 2000). AL- Farooque *et al.* (2019) identified a significant positive impact of the size of the BOD on the FP on their investigation on the influence of board, AC characteristics, and ownership structure on the market-based FP of Thailand listed firms. Further, they emphasized that increasing high caliber, skilled and experienced directors would help to handle the problems of the organization and enhance the FP. These consistency outcomes are also compatible with some past studies where they have also supported the idea that, when the number of well-experienced directors increases, it would enhance the board diversity and independence which would ultimately affect FP positively (Ciftci *et al.*, 2019; Tornyeva & Werekó, 2012).

Nevertheless, the mere presence of large boards does not lead to better FP. When the board consists of a higher number of directors, it may lead to unstable communication between directors and the process of decision making. Further, it is said that when BS gets beyond seven or eight members, they are less likely to function efficiently and become easier for CEOs to control. Also, having a large board would result in poor monitoring and supervision of the activities, which will eventually lead to poor FP (Jensen, 1993). Additionally, it

is believed that large boards are inefficient in terms of over-maintenance and due to the increase in the number of members, it would pose greater difficulties in planning, work coordination, decision-making and regular meetings. Conversely, small boards can ideally avoid board free riding and facilitate an efficient decision-making process. The larger the board, the more likely it is to benefit the interest of the stakeholders and the less likely it is to make decisions that are in favor of multiple members (Shao, 2010). Planiappan (2017) found that BS is an important variable and there is a negative relationship between BS and FP. Such observation supports the findings of O'Connell and Cramer (2010) where they also make this point by uncovering that board size has a significant negative influence on FP, measured by ROA in the Irish Stock Market. The study of Onuorah *et al.* (2018) further confirms that when the board gets smaller, it would promote the level of cohesion and collaboration among the directors and managers, which is expected to increase the financial reporting quality. In addition to that, an empirical study that has been undertaken based on 122 Nigerian quoted firms also further strengthens this argument that the size of BOD has a strong negative effect on FP (Ujunwa, 2012). These results are also in line with the empirical study of Nauyen, Locke, and Reddy (2014) in the context of non-financial listed firms in Singapore, where they also suggest that the BS has a significant negative impact on FP after controlling for endogeneity issues. On the other hand, the research conducted by Assenga *et al.* (2018) on the effect of board characteristics on the financial performance of listed firms in Tanzania did not find any association between BS and the FP. Moreover, some authors also have agreed with this notion by proving the fact of the insignificant relationship between BS and FP (Ferrer & Banderlipe, 2012; Garba & Abubakar, 2014). Therefore, in conclusion, it can be seen that conflicting inferences have been drawn from prior literature as they have supported both large and small BS.

## **2.6. Empirical evidence Audit Committee characteristics and Financial performance**

When exploring the previous studies, it is evident that the relationship between the size of the AC and the FP is inconclusive as some investigations have concluded that there is a positive relationship while others have proven that there is a negative relationship between AC and FP (Al-Matar *et al.*, 2014). According to Tornyeva and Wereko (2012), the size of the AC is a key factor in determining FP. Reflecting the evidence from the US, Qin (2007) found that larger AC size, along with the financial expertise of its members results in higher

earnings quality which will ultimately lead to higher FP. To further support this statement, some scholars have also made this point by identifying a significant positive association between AC size and FP with respect to different work settings (Abeygunasekera *et al.*, 2021; Al-Farooque *et al.*, 2019; Rahman *et al.*, 2019). Moreover, using the data of both family and non-family firms, Al-Okaily and Naueihed (2019) have pointed out that the size of AC of non-family firms carries out a positive and significant relationship with FP while no significant relationship with family firms.

Contradictory to the above mentioned evidence, Al-Matari *et al.* (2012) disagree that the larger AC leads to an increase the FP by identifying an inverse association between the size of the AC and FP. Similarly, Afza and Nazir (2014) also report a significant negative relationship between AC size and FP, emphasizing that the existence of larger AC leads to devoid of efficiency. Meanwhile, Bouaine and Hrichi (2018), Romano *et al.* (2012), Al-Okaily and Naueihed (2019) suggested that AC size has no significant relationship with FP.

Considering the AC frequency, it is recommended by the CG guidelines (2012) in Sri Lanka that an AC meeting should hold at least four times in a current financial year, and the time interval between two meetings should be within four months. Ultimately, AC is accountable to the board and should report to the BOD concerning conflicts of interests, suspected frauds, and misconduct, suspected infringement of laws and regulations. According to empirical evidence, it is said that more frequent meetings would facilitate AC to prepare a high standard financial statement in a shorter period of time than an AC that is held less frequently (Ionescu, 2014). A higher number of meetings is deemed as a favorable indicator of the AC to achieve their objectives productively (Bedard & Gendron, 2010). Alzoubi (2019) found that earnings management is more likely to be declined when there are frequent meetings between internal audit and AC. Nevertheless, based on the agency theory, it should be noted that the frequency of AC meetings can be beneficial to the organization only if the benefits gained from an additional meeting exceed the cost incurred for that particular meeting (Bouaine & Hrichi, 2018). The study of Xie *et al.* (2003) reveals that the AC most often will lead to improve the corporate earnings transparency, thus enhancing company performance through increasing earnings quality. Sharing the same perspective, studies of Aanu *et al.* (2014) and Alqatamin (2018) have also found that a greater number of audit meetings would positively result in FP. Similarly, Sultana (2015) has indicated that frequent audit conferences are positively correlated with conservativeness of accounting which eventually

enhances FP. Al-Okaily and Naueihed (2019) also make this point by identifying a positive association between frequencies of AC meetings on the performance of non-family firms. The investigation conducted by Zraiq and Fadzil (2018) reports that the AC meetings are significantly and positively related to ROA.

Yet, on the contrary, findings drawn by Rabeiz and Salameh (2006) have confirmed that a mere increase in the number of AC meetings does not necessarily improve the FP as it must also ensure the quality of such meetings. However, Bansal and Sharma (2016) concluded that the frequency of AC meetings has an insignificant impact on FP in terms of ROE while negatively impact with ROA. The same conclusion has been reached by Farhan *et al.* (2017) in their study of public listed firms in the UAE, and the results concluded that AC meetings have no effect on FP. That could be due to the fact that the formation of the AC in the UAE CG code is mandatory, so the committee should meet four times annually irrespective of the quality or reality of the meetings. Furthermore, by utilizing a sample of listed manufacturing firms in the Dhaka Stock Exchange, Rahman *et al.* (2019) has unveiled a significant negative association between AC meetings and company performance. These results are subsequently supported by other studies (e.g. Balagobei & Velnampy, 2018; Hsu & Petchsakulwong, 2010).

The aftermath of the recent financial crises and past corporate scandals have extensively highlighted the necessity of skilled and qualified members on the AC (Güner *et al.*, 2008). At present, regulatory officials across the globe have responded and mandated the inclusion of AC to be at least one financial specialist with relevant experience in the fields of accounting, auditing, or financing (Ahmed Haji & Anifowose, 2016). A financial specialist can be either an accounting professional or an expert in other fields of finance (DeFond & Zhang, 2014). According to Ahmed Haji (2015), the presence of financial or accounting specialists in the AC reduce disputes between management and external auditors and enhance financial and non-financial disclosures. Carcello *et al.* (2006) conclude that having both accounting and non-accounting financial professionals on an AC would reduce abnormal accruals. Most of the empirical studies have manifested that the financial expertness of the auditors can influence the earning quality and enhance the timeliness of the financial reporting system (Kallamu & Saat, 2015; Dinu & Nedelcu, 2015; Velte, 2017). Dakhlallah *et al.* (2020) also make this point by claiming that the expertise of the AC is positively and significantly linked with FP. In addition, the study performed by Al- Okaily and Naueihed (2019) has contended that the know-how of AC is positively

associated with the financial performance of UK non-family corporations while insignificantly associated with the performance of family corporations. For this reason, improving company performance relies upon the controlling power of the firms. Chaudhry *et al.* (2020) have discovered that the financial and monitoring expertise of the chair of AC has a significant positive impact on FP whereas the experiential expertise of the chair of AC does not indicate a significant influence on FP.

However, Bouaine and Hrichi (2019) in their study on the impact of AC and its characteristics on FP in French companies, have confirmed that the financial expertise of auditors has no impact on the FP indicated by ROA and ROE. In line with the above results, Chan *et al.* (2011) have also not found any direct impact of the financial expertise on the firm value. Further, they elaborated their findings by justifying that the firm value is affected by the compliance to all the requirements of CG code regarding the AC's attributes. Similarly, Farhan *et al.* (2017), and Carcello *et al.* (2011) also evidenced an insignificant relationship between AC competencies and FP. Refer to Appendix-A to see the summary of the empirical findings of board size and AC characteristics.

### **3. RESEARCH METHODOLOGY**

#### **3.1. Data Collection Sampling**

This study used a quantitative research approach. The motivation for selecting the banking sector can be reason out, it being a well-regulated industry, and governance structure is given serious attention because of the crucial role that banks play in the economy. As per the CG requirements in Sri Lanka, firms are bound to provide the details of board composition, AC meetings in their annual reports. Hence, the data and information were collected using annual reports of LCB in Sri Lanka from 2016 to 2019 to study the behavior of these variables in recent years. Considering the sample of the study, the researchers used the entire population as the sample, which consists of 24 LCB in Sri Lanka from 2016 to 2019.

#### **3.2. Hypothesis Development**

The mere presence of large boards does not lead to better FP (Jensen, 1993). Most of the literature (Kyereboah *et al.*, 2006; Palaniappan 2017; Shao, 2010; Ujunwa, 2012; Palaniappan, 2017; Onuorah *et al.*, 2018) support the argument that a lesser board size would be preferred for larger board size. Hence, with

the support of the arguments in the literature, the first hypothesis was developed as follows.

H1a: There is a negative relationship between board size (BS) and financial performance in terms of ROA (Kyereboah *et al.*, 2006; Palaniappan 2017)

H1b: There is a negative relationship between board size (BS) and financial performance in terms of ROE (O'Connell & Cramer 2010; Palaniappan 2017)

Based on the prior literature, the AC is considered as an additional internal governance mechanism whose influence may improve the quality of financial reporting and performance of a company and thus its performance. In this respect, an AC has three main characteristics that should be taken into consideration, these are; AC expertise, AC size, and AC meetings. Hence, in the study, we consider the size of the AC (measured by the number of members of AC), AC expertise (measured as a proportion of the members with recent and relevant financial experience to the total number of AC members), and frequency of AC meetings (measured by the number of meetings held per year) have a positive impact on financial performance in terms of ROA and ROE. However, as stated in the literature review section, there were also some studies that proved the contrary situations, so we believe it is necessary to test these three hypotheses in order to discover the relationship between board size, AC attributes, and firm performance in Sri Lankan context.

Therefore, with the support of the literature, AC characteristics (Al-Farooque *et al.*, 2019; Dakhlallah *et al.*, 2020; Palaniappan, 2017; Zraiq & Fadzil, 2018) following hypotheses were designed.

H2a: There is a positive relationship between the size of the AC and financial performance in terms of ROA (Abeygunasekera *et al.*, 2021; Hasan, Molla & Khan, 2019).

H2b: There is a positive relationship between the size of the AC and financial performance in terms of ROE (Hasan *et al.*, 2019; Zájbojníková, 2016).

H3a: There is a positive relationship between the frequency of AC meetings and financial performance in terms of ROA (Alabdullah & Ahmed, 2020; Zraiq & Fadzil, 2018).

H3b: There is a positive relationship between the frequency of AC meetings and financial performance in terms of ROE (Alabdullah & Ahmed, 2020; Zájbojníková, 2016).

H4a: There is a positive relationship between AC expertise and financial performance in terms of ROA. (Aanu *et al.*, 2014; Chaudhry *et al.*, 2020)

H4b: There is a positive relationship between AC expertise and financial performance in terms of ROE. (Aanu *et al.*, 2014; Zábajníková, 2016)

### 3.3. Conceptualization

Based on the hypotheses identified above, we can identify the conceptual framework as follows.

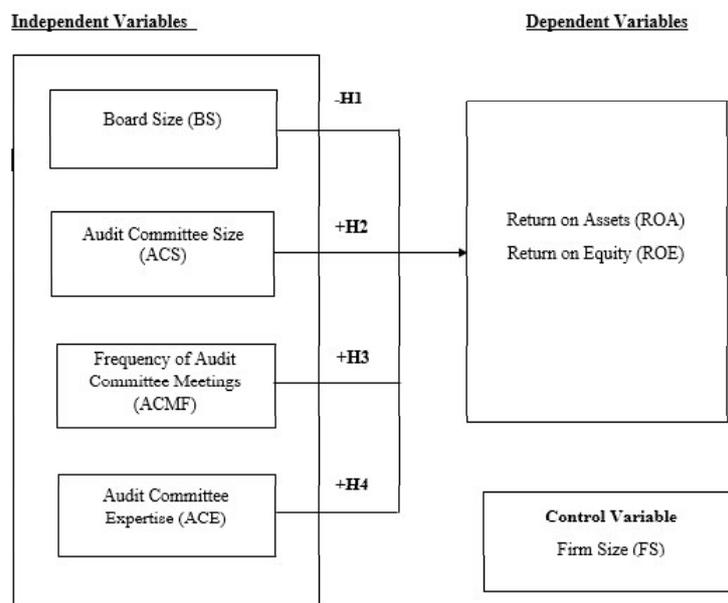


Figure 1: Conceptual Framework

When conceptualizing the relationship between BS and FP, theoretically, a negative relationship can be seen with respect to both BS and FP based on the agency theory and stewardship theory as the large board members being the agents, tend to look after their own interests rather than stakeholders' interest. However, according to the resource dependency theory, a larger number of directors on the board might be beneficial for the monetary performance of the firm, the larger size of the board directors in the board may give more opportunities than smaller boards. Practically, the size of the board is subjective depending on the size of the organization, and maintaining an optimal board size is advisable with the evidence in the literature.

Regarding AC characteristics and FP, the resource dependency theory presumes that the AC serves as a source of advice and counsel for the BOD to bring valuable resources to the organization (Zábojníková, 2016) and the have a positive relationship between AC characteristics and FP. When a small AC lacks with diversified skills and expertise provided by a large AC, it would make them ineffective. An AC with an appropriate amount of members allows them to make use of their knowledge for stakeholders' advantage (Goodstein *et al.*, 1994). Even though several contrary results were found, most of the empirical studies also supported this theoretical relationship where the conceptual framework has been developed based on findings of the literature.

### 3.4. Operationalization of Variables

Table 1 shows the operationalization of variables of the study.

**Table 1**  
**Operationalization of the Variables for the Regression Analysis**

<i>Variables</i>	<i>Indicators</i>	<i>Measurement</i>	<i>Sources</i>
<b>Independent Variables</b>			
Board Size(BS)	Number of directors serving on the board	Total number of directors who comprise board of directors at the end of the financial year	Assenga <i>et al.</i> , 2019; Palaniappan, 2017
Audit committee size (ACS)	Number of members constituting the audit committee	Total number of members in the audit committee	Al Farooque <i>et al.</i> , 2019; Dakhlallah <i>et al.</i> , 2020
Audit committee meeting frequency (ACMF)	Number of audit committee meetings in a fiscal year	The total number of gatherings that the audit committee hold during a financial year	Al Farooque, <i>et al.</i> , 2019; Sultana, 2015
Audit committee expertise (ACE)	The number of members with different areas of expertise on the audit committee.	Total number of members with expertise in accounting, auditing and finance on the audit committee	Alzeban, 2020; Dakhlallah <i>et al.</i> , 2020
<b>Dependent Variables</b>			
Financial performance	Return on Assets (ROA)	Net Income divided by total assets	Assenga <i>et al.</i> , 2019; Isik and Ince (2016)
	Return on Equity(ROE)	Net Income divided by shareholders' equity	Assenga <i>et al.</i> , 2019; Zábojníková (2016)
<b>Control Variable</b>			
Firm Size(FS)	Natural logarithm of total assets	Log (Assets of bank/ Total assets value	Alzeban, 2020; Alqatamin, 2018

*Source:* Compiled by Researchers (2021)

### 3.5. Model Specification

To investigate the relationship between board size and AC characteristics on FP, it is decided to use one Multiple Panel Regression Model using the Ordinary Least Square (OLS) method following the works of scholars namely Palaniappan (2017), and Zábajníková (2016). It will clearly demonstrate the impact of BS and AC characteristics (independent variables) with FP (dependent variable).

$$ROA_{i,t} = \alpha + \beta_1 BS + \beta_2 ACS + \beta_3 ACMF + \beta_4 ACE + \beta_5 FS + \varepsilon \quad (01)$$

$$ROE_{i,t} = \alpha + \beta_1 BS + \beta_2 ACS + \beta_3 ACMF + \beta_4 ACE + \beta_5 FS + \varepsilon \quad (02)$$

Where,

$\alpha$  = Constant

BS = Board Size for company i at the year t

ACS = Audit Committee Size for the company i at the year t

ACMF = Audit Committee Meeting Frequency for the company i at the year t

ACE = Audit Committee Expertise for the company i at the year t

FS = Firm Size for the company i at the year t

ROA = Return on Assets for the company i at the year t

ROE = Return on Equity for the company i at the year t

$\varepsilon$  = Error term of the model

Before deriving the final output, we have tested the pre-diagnosis tests of the regression analysis. Thereby, we tested for Normality, Multicollinearity and Autocorrelation and satisfied. Furthermore, when determining whether to employ a fixed or random model Hausman test was done and based on the findings of Hausman Test, the probability value is greater than 0.05 for both ROA and ROE models. Therefore, we employ with random effects model.

## 4. EMPIRICAL RESULTS

### 4.1. Descriptive Statistics

Under the descriptive analysis, firstly, a descriptive statistic on measures of central tendency (mean, median, and mode) is discussed. Secondly, the measures of variability (standard deviation or variance, the minimum and maximum values,

the kurtosis, and skewness) of the entire independent, dependent, and control variables are identified, referring to Table 2.

**Table 2**  
**Descriptive Statistics**

	<i>BS</i>	<i>ACS</i>	<i>ACMF</i>	<i>ACEX</i>	<i>ROA</i>	<i>ROE</i>
Mean	10.76042	4.656250	10.47917	2.375000	1.076771	12.17375
Maximum	20.00000	9.000000	22.00000	6.000000	2.320000	28.40000
Minimum	4.000000	3.000000	4.000000	1.000000	-2.410000	-5.960000
Std. Dev.	2.650699	1.442426	4.103860	1.038724	0.615846	6.101128
Skewness	0.287532	0.975730	0.491065	0.846212	-1.695901	0.081764
Kurtosis	4.057643	3.312456	2.648280	3.958144	11.90620	3.316333

The selected sample consists of 96 observations from 24 LCB in Sri Lanka from the period of 2016 to 2019. Based on the results of the above table, the considered dependent variables ROA and ROE denote a mean value of 1.076 and 12.173. The minimum value of ROA and ROE were found to be -2.410 and -5.960, respectively during the examined period with a maximum value of 2.320 and 28.400, respectively. When it comes to the board size in LCB in Sri Lanka, it indicates that on average, there are 10.76 on the board. Descriptive statistics show that the maximum number of directors is 20. Further, when it comes to ACS, it can be seen that the mean size of the ACS of LCB in Sri Lanka is 4 with a minimum value of 3 members to the maximum number of 9 members. CG code stipulates that the minimum number of AC members has to be no less than 3 in Sri Lankan context (CASL, 2017). In fact, based on the information presented in table 2, these values indicate that all the banks have complied with CG code recommendations according to the minimum AC members that are required to adhere. According to the results, it indicates that all the banks have been fulfilled the requirement of the Code of best practice recommendation regarding AC meeting frequency where they should meet at least four times a year. Similarly, LCB is adhered to the CG rules, which state that at least one member of the AC should have recent and relevant experience in financial reporting and control as per Table 2.

Relating to the measures of variability, many models are assumed to have a normal distribution with a skewness of zero. In reality, the data points may not be perfectly symmetric where it is evidenced through the results. Except for ROA, all the other variables are positively skewed.

**Table 3**  
**Correlation Analysis**

<i>Correlation Probability</i>	<i>BS</i>	<i>ACS</i>	<i>ACMF</i>	<i>ACEX</i>	<i>ROA</i>	<i>ROE</i>
BS	1.000000					
ACS	0.355408 0.0004	1.000000				
ACMF	0.001955 0.9849	0.207721 0.0423	1.000000			
ACEX	0.331176 0.0010	0.634938 0.0000	0.352501 0.0004	1.000000		
ROA	-0.268727 0.0081	-0.075798 0.4630	0.119404 0.2466	-0.001872 0.9856	1.000000	
ROE	-0.288053 0.0044	-0.057648 0.5769	0.103651 0.3149	-0.023279 0.8219	0.680848 0.0000	1.000000

Table 3 illustrates the results of the correlation analysis, which enables identifying the correlation between CG characteristics and FP in LCB in Sri Lanka. As per the result, no multicollinearity issue was found. With the results, it can be observed that the BS has a significantly weak negative relationship (-0.268727) with the FP measured by ROA. Further, it has depicted a significantly weak negative relationship (-0.288053) between BS and FP measured by ROE as well. So this demonstrates that when the board has more directors, the FP is less likely to take place. Further, the results of the correlation analysis between the size of the AC and FP measured by ROA indicate that there is a weak negative relationship between the two variables (-0.075798). Similarly, the association between the size of the AC and FP measured by ROE depicts a weak negative correlation of -0.057648 with a p- value of 0.5769 which is larger than 0.05 at a 5% significance level.

In terms of AC meeting frequency, the results have shown that the AC meeting frequency has a coefficient value of 0.119404 and 0.103651, respectively indicating a weak positive relationship with the FP measured by both ROA and ROE at a 5% significance level. According to the results of the correlation analysis, the final independent variable represented by AC expertise has illustrated a weak negative relationship with FP with a coefficient value of -0.001872 measured by ROA. Meanwhile, the correlation between the AC expertise and

FP measured by ROE has also shown a weak negative association of -0.023279 with a p-value of 0.8219 which is greater than 0.05 at a 5% significance level.

## 4.2. Regression Analysis

**Table 4**  
**Regression Analysis for ROA**

<i>Variable</i>	<i>Coefficient</i>	<i>t-Statistic</i>	<i>Prob.</i>
C	-0.128200	-0.268230	0.7894
BS	-0.015119	-0.735007	<b>0.0490**</b>
ACS	0.019964	0.589289	0.5577
ACMF	0.008438	0.759498	0.4503
ACEX	0.115625	1.490097	0.1410
R-squared	0.404613		
Adjusted R-squared	0.349655		
S.E. of regression	0.505559		
F-statistic	7.362129		
Prob(F-statistic)	0.000005		
Durbin-Watson stat	1.273844		

*Note:* Dependent variable ROA. \*\* indicates significant at 5% level.

**Table 5**  
**Regression Analysis for ROE**

<i>Variable</i>	<i>Coefficient</i>	<i>t-Statistic</i>	<i>Prob.</i>
C	1.072912	0.476625	0.6352
BS	-0.186218	-1.630040	<b>0.0039**</b>
ACS	0.160399	0.654903	0.5148
ACM	-0.010782	-0.112268	0.9110
ACEX	1.094207	2.930503	<b>0.0047**</b>
R-squared	0.729993		
Adjusted R-squared	0.705069		
S.E. of regression	2.262560		
F-statistic	29.28903		
Prob(F-statistic)	0.000000		
Durbin-Watson stat	1.792577		

*Note:* Dependent variable ROE. \*\* indicates significant at 5% level.

The outcomes of the regression indicate that the BS has a significant negative impact on FP measured by both ROA (-0.0151) and ROE (-0.1862). These results are consistent with the previous empirical findings of Guest (2009); Martin and Herrero (2018); O'Connell and Cramer (2010); Palaniappan (2017); Razill *et al.* (2019), who also confirm the significant negative relationship between BS and FP indicated by ROA and ROE. However, these findings are not supported by the prior studies of Al Farooque *et al.* (2019); Ciftci, *et al.* (2019) where they discovered a positive relationship between BS and FP.

The second overall finding states that there is a positive yet insignificant relationship between AC size and FP measured by ROA (0.0199) and ROE (0.1603). Such results are in line with the most recent work of Qeshta *et al.* (2021); Bouaine and Hrichi (2019); Zraiq and Fadzil (2018); Romano *et al.* (2012). The reason behind this insignificant impact is due to the fact that the increase in professional fees of the members in the AC. When AC becomes larger, it may lead to an increase in the compensation of AC members which ultimately creates an insignificant impact on FP. This implies the impact of AC size on FP cannot be proven. However, these results are contradictory to the findings of Abeygunasekera *et al.* (2021), and Tornyeva and Werekó (2012).

Relating to AC meeting frequency, the present study has revealed that the frequency of AC meetings depicts an insignificant positive relationship with FP measured by ROA (0.0084) while insignificantly negative with ROE (-0.0107). These findings are similar and consistent to empirical studies of Aanu *et al.* (2014); Amer *et al.* (2014); Bansal and Sharma (2016); Bouaine and Hrichi (2019), and Rabeiz and Salameh (2006) where it shows inconsistent results with Abeygunasekera *et al.* (2021); Alqatamin (2018), and Rahman *et al.* (2019).

The final outcome regarding to AC expertise in this study has found that the AC expertise has no significant impact on FP indicated by ROA (0.1156) whereas a significantly positive impact on FP indicated by ROE (1.0942). Results are in the agreement with the findings of Bouaine and Hrichi (2019), Chaudhry *et al.* (2020), and Qeshta *et al.* (2021).

The finding relating to the impact of AC expertise on ROE is much aligned with existing literature (i.e. Zábajníková, 2016); Al-Matari *et al.*, 2012; Nuhu *et al.*, 2017) which confirmed a significantly positive relationship between AC expertise and FP measured by ROE.

## **5. DISCUSSION AND CONCLUSION**

The researchers have fulfilled the main objective by showing a significant negative impact between BS and FP. Further, this significant negative impact between board size and FP has been accepted by most of the prior studies which imply the necessity of an optimal BS that could lead to enhanced the financial performance of the firms. The reason for this association can be explained by the fact that when the board consists of a higher number of members, it will become difficult to manage the firm and would lead to a decrease in overall organizational performance. Another justification is that the board cannot perform itself effectively due to a lack of communication, collaboration, and problems in decision making process that occur as a result of larger boards (Guest, 2009).

Especially with regard to the banking sectors in Sri Lanka, as it has a unique business model thoroughly governed by the Central Bank of Sri Lanka the reporting requirements, the monitoring process is highly regulated. Hence, the board of directors needs to closely supervise the business in formulating the monetary policies, asset valuations, and decisions regarding the non-performing loans, etc. Accordingly, a less number of members in the board may be effective and easily manageable, and more accountable in the banking sector rather than having many directors. Hence, it can be seen that the present study gained plenty of empirical evidence by highlighting both global and Sri Lankan contexts in order to obtain a theoretical nexus between board size and FP in LCB in Sri Lanka.

As a result of achieving the second objective, the findings related to AC characteristics depicted mixed and conflicting results in relation to FP. These conclusions relating to each AC variable have been confirmed by most of the past scholars with respect to their different research settings. Nevertheless, most of the variables (AC size, AC meeting frequency, and measured by ROA) demonstrated an insignificant association with FP. However, AC expertise shows a positive impact on FP emphasizing the importance of having financial expert knowledge in the board. The need for expert directors on the AC was emphasized as a result of prior financial crises and previous corporate scandals. In the context of banks, as the major function of AC is to monitor financial performance and ensure the integrity of financial reporting, AC expertise is an integral component of the members of AC. The directors will be more efficient and specialized their decisions due to their technical expertise, experience, and knowledge about the company, and the banking industry when they are from an accounting,

auditing, and finance background. Furthermore, the presence of accounting or finance expert will help to prevent the incidence of accounting misstatement, help reduce the possibility of litigation against the company, and reduce the attention of regulators on the company.

Since both management and investors are concerned about CG and FP, this research has provided light on the pathway to determining the significant negative impact between BS and FP. Similarly, AC expertise shows a positive impact on FP. Finally, it concludes, smaller the BS, higher the performance in terms of ROA, and ROE together with the area expert knowledge in LCB in Sri Lanka. Further it provides policymakers a better understanding of the various characteristics required by an AC, which can be incorporated into future policy implementation to preserve shareholders' wealth, safeguard the interests of all stakeholders, develop the flow of capital and encourage foreign direct investment into both financial and non-financial companies and the economy as a whole.

Despite the above mentioned contributions, the present study itself has some boundaries and limitations. The period is limited to 2016 to 2019 and the sample is limited to twenty-four LCB which represents the whole population. Hence, it is suggested to further examine the topic of CG and financial performance for the other sectors and see whether CG will influence the company's performance. Furthermore, we suggest that future researchers extend the period, and employ more possible proxies to denote CG and we recommend examining the same as cross-country studies.

### **References**

- Aanu, O. S., Odianonsen, I. F., & Foyeke, O. I. (2014). Effectiveness of audit committee and firm financial performance in Nigeria: An empirical analysis. *Journal of Accounting and Auditing*, 2014(1). ID 301176.
- Abeygunasekera, A. W. J. C., Weerasuriya, R. M. I. H., & Kehelwalatenna, S. (2021). Effect of attributes of audit committee on financial performance: The case of Sri Lanka. *Global Review of Accounting and Finance*, 12(1), 43–57.
- Afza, T., & Nazir, M. S. (2014). Audit quality and firm value: A case of Pakistan. *Research Journal of Applied Sciences, Engineering and Technology*, 7(9), 1803-1810.
- Ahmed Haji, A. (2015). The role of audit committee attributes in intellectual capital disclosures: Evidence from Malaysia. *Managerial Auditing Journal*, 30(8/9), 756–784.
- Ahmed Haji, A., & Anifowose, M. (2016). Audit committee and integrated reporting practice: Does internal assurance matter? *Managerial Auditing Journal*, 31(8/9), 915–948.

- Alabdullah, T. T. Y., & Ahmed, E. R. (2020). Audit committee impact on corporate profitability in Oman companies: an auditing and management accounting perspective. *Riset Akuntansi dan Keuangan Indonesia*, 5(2), 121-128.
- Al Farooque, O., Buachoom, W., & Sun, L. (2019). Board, audit committee, ownership and financial performance – Emerging trends from Thailand. *Pacific Accounting Review*, 32(1), 54–81.
- Ali, M. (2014). Relationship between financial leverage and financial performance (evidence of listed chemical companies of Pakistan). *Research Journal of Finance and Accounting*, 5(23), 46-56.
- Al Mamun, A., Yasser, Q. R., & Rahman, M. A. (2013). A discussion of the suitability of only one vs more than one theory for depicting corporate governance. *Modern Economy*, 4(1), 37-48.
- Al-Matari, E. M., Al-Swidi, A. K., & Fadzil, F. H. B. (2014). The effect of board of directors' characteristics, audit committee characteristics and executive committee characteristics on firm performance in Oman: An empirical study. *Asian Social Science*, 10(11), 149-171.
- Al-Matari, Y. A., Al-Swidi, A. K., Fadzil, F. H. B., & Al-Matari, E. M. (2012). Board of Directors, Audit Committee Characteristics and Performance of Saudi Arabia Listed Companies. *International Review of Management and Marketing*, 2(4), 241–251.
- Al-Okaily, J., & Naueihed, S. (2019). Audit committee effectiveness and family firms: Impact on performance. *Management Decision*, 58(6), 1021–1034.
- Alqatamin, R. M. (2018). Audit Committee Effectiveness and Company Performance: Evidence from Jordan. *Accounting and Finance Research*, 7(2), 48–60.
- Al-Thuneibat, A. (2006). Audit in the light of the international auditing standards and regulations and local laws: *The theory and application*, (1st ed). Jordan University publications.
- Alzeban, A. (2020). The relationship between the audit committee, internal audit and firm performance. *Journal of Applied Accounting Research*, 21(3), 437–454.
- Alzoubi, E. S. S. (2014). Board characteristics and financial reporting quality: Evidence from Jordan. *Corporate Ownership and Control*, 11(3), 8-29.
- Alzoubi, E. S. S. (2019). Audit committee, internal audit function and earnings management: Evidence from Jordan. *Meditari Accountancy Research*, Emerald Group Publishing, 27(1), 72–90.
- Amer, M., Ragab, A. A., & Shehata, S. E. (2014). Audit Committee Characteristics and Firm Performance: Evidence from Egyptian Listed Companies. *Proceedings of 6th Annual American Business Research Conference*, 1–25.
- Arens, A.A., Elder, R.J., and Beasley, M.S. (2009). *Auditing and Assurance Services: An Integrated Approach*, 13th Ed., New Jersey: Prentice Hall.

- Assenga, M. P., Aly, D., & Hussainey, K. (2018). The impact of board characteristics on the financial performance of Tanzanian firms. *Corporate Governance: The International Journal of Business in Society*, 18(6), 1089–1106.
- Balagobei, S., & Velnampy, T. (2018). Impact of audit committee on organizational performance of listed hotels and travels in Sri Lanka. *International Journal of Accounting and Financial Reporting*, 8(4), 352–369.
- Bansal, N., & Sharma, A. K. (2016). Audit committee, corporate governance and firm performance: Empirical evidence from India. *International Journal of Economics and Finance*, 8(3), 103-116.
- Bédard, J., & Gendron, Y. (2010). Strengthening the financial reporting system: Can audit committees deliver? *International journal of auditing*, 14(2), 174-210.
- Bouaine, W., & Hrichi, Y. (2019). Impact of audit committee adoption and its characteristics on financial performance: Evidence from 100 French companies. *Accounting and Finance Research*, 8(1), 92-102.
- Cadbury, A (1992). *Report of the Committee on the Financial Aspects of Corporate Governance*. London, Gee and Co Ltd.
- Carcello, J. V., Hollingsworth, C. W., Klein, A., & Neal, T. L. (2006). Audit Committee Financial Expertise, Competing Corporate Governance Mechanisms, and Earnings Management [University of Tennessee, New York University].
- Carcello, J. V., Neal, T. L., Palmrose, Z. V., & Scholz, S. (2011). CEO involvement in selecting board members, audit committee effectiveness, and restatements. *Contemporary Accounting Research*, 28(2), 396-430.
- Chan, R. S. Y., Lau, C. K. S., & Ng, A. W. (2011). Compliance and value relevance of audit committees: Evidence from Hong Kong. *Journal of Financial Reporting and Accounting*, 9(1), 74–97.
- Chaudhry, N. I., Roomi, M. A., & Aftab, I. (2020). Impact of expertise of audit committee chair and nomination committee chair on financial performance of firm. *Corporate Governance: The International Journal of Business in Society*, 20(4), 621–638
- Ciftci, I., Tatoglu, E., Wood, G., & Demirbag, M. (2019). Corporate governance and firm performance in emerging markets: Evidence from Turkey. *International Business Review*, 28(1), 90–103.
- Dakhlallh, M. M., Rashid, N., Abdullah, W. A. W., & Al Shehab, H. J. A. (2020). Audit committee and Tobin's Q as a measure of firm performance among Jordanian companies. *Journal of Advanced Research in Dynamical & Control Systems*, 12(1), 28-41.
- DeFond, M., & Zhang, J. (2014). A review of archival auditing research. *Journal of Accounting and Economics*, 58(2–3), 275–326.

- Dinu, V., & Nedelcu, M. (2015). The relationship between the audit committee and the financial performance, the asset quality and the solvency of banks in Romania. *Transformations in Business & Economics*, 14(2), 161-173.
- Donaldson, L. (1990). The ethereal hand: Organizational economics and management theory. *The Academy of Management Review*, 15(3), 369-381
- Donaldson, L., & Davis, J. H. (1991). Stewardship theory or agency theory: CEO governance and shareholder returns. *Australian Journal of management*, 16(1), 49-64.
- Donaldson, L., & Davis, J. H. (1994). Boards and company performance – Research challenges and conventional wisdom. *Corporate Governance: An International Review*, 2(3), 151-161.
- Eichenseher, J. W., & Shields, D. (1985). Corporate director liability and monitoring preferences. *Journal of Accounting and Public Policy*, 4(1), 13-31.
- Fama, E. F. (1980). Agency problems and the theory of the firm. *Journal of Political Economy*, 88(2), 288-307.
- Farhan, A., Obaid, S. N., & Azlan, H. (2017). Corporate governance effect on firms' performance – evidence from the UAE. *Journal of Economic and Administrative Sciences*, 33(1), 66–80.
- Ferrer, R. C., & Banderlipe, R. S. (2012). The influence of corporate board characteristics on firm performance of public listed property companies in the Philippines. *Academy of Accounting and Financial Studies Journal*, 16(4), 123–142.
- Garba, T., & Abubakar, B. A. (2014). Corporate board diversity and financial performance of insurance companies in Nigeria: An application of panel data approach. *Asian Economic and Financial Review*, 4(2), 257–277.
- Gompers, P., Ishii, J., & Metrick, A. (2003). Corporate governance and equity prices. *The Quarterly Journal of Economics*, 118(1), 107-156.
- Goodstein, J., Gautam, K., & Boeker, W. (1994). The effects of board size and diversity on strategic change. *Strategic management journal*, 15(3), 241-250.
- Guest, P. M. (2009). The impact of board size on firm performance: Evidence from the UK. *European Journal of Finance*, 15(4), 385–404.
- Güner, A. B., Malmendier, U., & Tate, G. (2008). Financial expertise of directors. *Journal of financial Economics*, 88(2), 323-354.
- Hamdan, A. M. M., & Mushtaha, S. M. S. (2011). The Relationship between audit committee characteristics and type of auditor's report: An empirical study on the public shareholding industrial companies listed at Amman bourse. *The Arabian Journal of Accounting*, 14(1), 109-163.
- Hasan, M. T., Molla, M. S., & Khan, F. (2019). Effect of board and audit committee characteristics on profitability: Evidence from pharmaceutical and chemical industries in Bangladesh. *Finance & Economics Review*, 1(1), 64-76.

- Herdjiono, I., & Sari, I. M. (2017). The effect of corporate governance on the performance of a company. Some empirical findings from Indonesia. *Central European Management Journal*, 25(1), 33-52.
- Heremans, D. (2007). Corporate Governance Issues for Banks: A Financial Stability Perspective. *CEIS-Discussion Paper Series (DPS) 07.07*, 1-28.
- Hsu, W. Y., & Petchsakulwong, P. (2010). The impact of corporate governance on the efficiency performance of the Thai non-life insurance industry. *The Geneva Papers on Risk and Insurance-Issues and Practice*, 35(1), 28-49.
- Ionescu, L. (2014). Audit committees as a governance device. *Economics, Management, and Financial Markets*, 9(2), 127-132.
- Isik, O., & Ince, A. R. (2016). Board size, board composition and performance: An investigation on Turkish banks. *International Business Research*, 9(2), 74-84.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of financial economics*, 3(4), 305-360.
- Kallamu, B. S., & Saat, N. A. M. (2015). Audit committee attributes and firm performance: Evidence from Malaysian finance companies. *Asian Review of Accounting*, 23(3), 206–231.
- Kalsie, A., & Shrivastav, S. M. (2016). Analysis of board size and firm performance: Evidence from NSE companies using panel data approach. *Indian Journal of Corporate Governance*, 9(2), 148-172.
- Kusnadi, Y., Leong, K. S., Suwardy, T., & Wang, J. (2016). Audit committees and financial reporting quality in Singapore. *Journal of business ethics*, 139(1), 197-214.
- Kyereboah-Coleman, A., & Biekpe, N. (2006). The relationship between board size, board composition, CEO duality and firm performance: Experience from Ghana. *Corporate Ownership and Control*, 4(2), 114-122.
- Mak, Y. T., & Roush, M. L. (2000). Factors affecting the characteristics of boards of directors: An empirical study of New Zealand initial public offering firms. *Journal of Business Research*, 47(2), 147-159.
- Manawaduge, A. S. (2012). Corporate governance practices and their impacts on corporate performance in an emerging market: The case of Sri Lanka. (Doctor of Philosophy), University of Wollongong, New South Wales, Australia. 1-358
- Martín, C. J. G., & Herrero, B. (2018). Boards of directors: Composition and effects on the performance of the firm., *Economic Research-Ekonomska Istraživanja* 31(1), 1015–1041.
- Matar, A., & Eneizan, B. M. (2018). Determinants of financial performance in the industrial firms: Evidence from Jordan. *Asian Journal of Agricultural Extension, Economics & Sociology*, 22(1) 1-10.
- Mitnick, B. M. (1973). Fiduciary rationality and public policy: The theory of agency and some consequences. In 1973 Annual Meeting of the American Political Science

- Association, New Orleans, LA. In *Proceedings of the American Political Science Association*.
- Nguyen, T. V., Locke, S. M., & Reddy, K. (2014). A dynamic estimation of governance structures and financial performance for Singaporean companies. *Economic Modelling*, 40(1), 1–11.
- Ntim, C. G. (2009). Internal Corporate Governance Structures and Firm Financial Performance: Evidence from South African Listed Firms. Department of Accounting and Finance, Faculty of Law, Business and Social Sciences, University of Glasgow.
- Ntim, C. G. (2015). Board diversity and organizational valuation: Unravelling the effects of ethnicity and gender. *Journal of Management & Governance*, 19(1), 167–195.
- Nuhu, M. S., Umaru, S. Y., & Salisu, S. (2017). The effect of audit committee's quality on the financial performance of food and beverages industry in Nigeria. *International Journal of Business and Management Invention*, 6(9), 32–40.
- O'Connell, V., & Cramer, N. (2010). The relationship between firm performance and board structure in Ireland. *European Management Journal*, 28(5), 387–399.
- Onuorah, O. A., Egbunike, F. C., & Gunardi, A. (2018). The Influence of Corporate Board Attributes on Voluntary Social Disclosure of Selected Quoted Manufacturing Firms in Nigeria. *Indonesian Journal of Applied Business and Economic Research*, 1(1), 20–33.
- Onuorah, A. C. C., & Imene, O. F. (2016). Corporate governance and financial reporting quality in selected Nigerian company. *International Journal of Management Science and Business Administration*, 2(3), 7–16.
- Palaniappan, G. (2017). Determinants of corporate financial performance relating to board characteristics of corporate governance in Indian manufacturing industry: An empirical study. *European Journal of Management and Business Economics*, 26(1), 67–85.
- Paulinus, E. C., Oluchukwu, N., & Somtochukwu, O. (2017). Empirical investigation of corporate governance and financial reporting quality of quoted companies in Nigeria. *International Journal of Economics, Business and Management Research*, 1(5), 117–137.
- Pfeffer, J. (1972). Size and composition of corporate boards of directors: The organization and its environment. *Administrative Science Quarterly*, 17(2), 218–228.
- Pfeffer, J., & Salancik, G. R. (1978). *The External Control of Organizations: A Resource Dependence Perspective*. University of Illinois at Urbana-Champaign's Academy for Entrepreneurial Leadership Historical Research Reference in Entrepreneurship.
- Qeshta, M. H., Alsoud, G. F. A., Hezabr, A. A., Ali, B. J. A., & Oudat, M. S. (2021). Audit committee characteristics and firm performance: Evidence from the insurance sector in Bahrain. *Revista Geintec-Gestao Inovacao E Tecnologias*, 11(2), 1666–1680.

- Qin, B. (2007). The influence of audit committee financial expertise on earnings quality: US evidence. *The ICFEI Journal of Audit Practice*, 4(3), 7-28.
- Rebeiz, K. S., & Salameh, Z. (2006). Relationship between governance structure and financial performance in construction. *Journal of Management in Engineering*, 22(1), 20-26.
- Rahman, M. M., Meah, M. R., & Chaudhory, N. U. (2019). The impact of audit characteristics on firm performance: An empirical study from an emerging economy. *The Journal of Asian Finance, Economics, and Business*, 6(1), 59-69.
- Razali, M. W. M., Hwang, J. Y. T., Uzairi, M., Hajazi, A., & Lunyai, J. (2019). Board structure and corporate's performance: Evidence from private education companies. *International Journal of Academic Research in Progressive Education and Development*, 8(4), 141-156.
- Romano, G., Ferretti, P., & Rigolini, A. (2012). Corporate Governance and Performance in Italian Banking Groups. In *Paper to be presented at the International conference*, 1-35.
- Ross, S. A. (1973). The economic theory of agency: The principal's problem. *The American Economic Review*, 63(2), 134-139.
- Safari, M. (2017). Board and audit committee effectiveness in the post-ASX corporate governance principles and recommendations era. *Managerial Finance*, 43(10), 1137-1151.
- Santos, J. B., & Brito, L. A. L. (2012). Toward a subjective measurement model for firm performance. *BAR - Brazilian Administration Review*, 9(special issue), 95-117.
- Senaratne, S., & Gunaratne, P. S. M. (2008). Corporate Governance Development in Sri Lanka: Prospects and Problems [Paper presentation]. *International Research Conference on Management and Finance*, University of Colombo.
- Shao, G. (2010). The effects of board structure on media companies' performance: A stakeholder perspective. *Journal of Media Business Studies*, 7(3), 1-16.
- Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. *The Journal of Finance*, 52(2), 737-783.
- Sultana, N. (2015). Audit committee characteristics and accounting conservatism. *International Journal of Auditing*, 19(2), 88-102.
- Topal, Y., & Dogan, M. (2014). Impact of board size on financial performance: The case of BIST manufacturing industry. *International Journal of Business Management and Economic Research*, 5(4), 74-79.
- Tornyeva, K., & Wereko, T. (2012). Corporate governance and firm performance: Evidence from the insurance sector of Ghana. *European Journal of Business and Management*, 4(13), 95-112.
- Triantis, G. C., & Daniels, R.J. (1995). The role of debt in interactive corporate governance. *University of California Law Review*, 83(4), 1073-1113.

- Tudose, M. B. (2012). Capital structure and firm performance. *Economy Transdisciplinarity Cognition*, 15(2), 76-82.
- Ujunwa, A. (2012). Board characteristics and the financial performance of Nigerian quoted firms. *Corporate Governance: The International Journal of Business in Society*, 12(5), 656–674.
- Uwuigbe, U., Felix, E. D., Uwuigbe, O. R., Teddy, O., & Falola, I. (2018). Corporate governance and quality of financial statements: a study of listed Nigerian banks. *Banks & bank systems*, 13 (3), 12-23.
- Velte, P. (2017). The link between audit committees, corporate governance quality and firm performance: A literature review. *Corporate Ownership and Control*, 14(4), 15–31.
- Weerasinghe, W. A. N. C. M., & Ajward, R. (2017). Issues of corporate governance practices in Sri Lanka: perceptions of professionals. *CA Journal of Applied Research*, 1(1), 1–19.
- Williamson, O. E. (1984). The economics of governance: framework and implications. *Zeitschrift für die gesamte Staatswissenschaft/Journal of Institutional and Theoretical Economics*, (H. 1), 195-223.
- Xie, B., Davidson III, W. N., & 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.
- Zábojníková, G. (2016). The Audit Committee Characteristics and Firm Performance: Evidence from the UK. 1-60
- Zabri, S. M., Ahmad, K., & Wah, K. K. (2016). Corporate governance practices and firm performance: Evidence from top 100 public listed companies in Malaysia. *Procedia Economics and Finance*, 100 (35), 287-296.
- Zraiq, M. A. A., & Fadzil, F. H. B. (2018). The impact of audit committee characteristics on firm performance: Evidence from Jordan. *Scholar Journal of Applied Sciences and Research*, 1(5), 39-42.

**To cite this article:**

Oshadhi De Silva & Yashodha Madhavi Hewage (2022). The Impact of Board Size and Audit Committee Characteristics on Firm's Financial Performance: Evidence from Licensed Commercial Banks in Sri Lanka. *Global Journal of Accounting and Economy Research*, Vol. 3, No. 1, 2022, pp. 5-34.

### APPENDIX-A

#### Summary of empirical evidences on the relationship between the board size and audit committee characteristics with firm performance

<i>Author(s)</i>	<i>Context</i>	<i>Findings</i>
Palaniappan (2017)	Indian manufacturing industry.	Inverse association between board size and firm performance.
Assenga <i>et al.</i> (2018)	Tanzanian firms.	Insignificant relationship between board size and firm performance.
Al- Farooque <i>et al.</i> (2019)	Listed firms in Thailand	Positive relationship between board size, AC meeting frequency on firm performance while insignificantly related with AC size.
Qeshta <i>et al.</i> (2021)	Listed Insurance companies in Bahrain.	Insignificant relationship between AC size and firm performance.
Bouaine and Hrichi (2019)	Listed French companies.	Insignificant relationship between AC size, meeting frequency and expertise with firm performance measured by ROE. Negative relationship between AC size, meeting frequency and expertise with firm performance measured by ROA.
Abeygunasekera <i>et al.</i> (2021)	Listed companies in Sri Lanka	Significant positive relationship between AC size and meeting frequency on financial performance.
Rahman <i>et al.</i> (2019)	Dhaka Stock Exchange (DSE).	Significant negative association between AC meeting and firm performance.
Al- Okaily and Naucihed (2019)	Listed public family firms and non-family firms in UK.	Positive relationship between AC size, meeting frequency and expertise with firm performance in family firms while insignificant relationship with family firms.