

# Corporate Governance and Earnings Quality: Evidence from Listed Banks and Insurance Firms

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## ABSTRACT

This study investigates the impact of corporate governance mechanisms on reported earnings quality of listed banks and insurance firms in Sri Lanka. Despite the fact that, many studies are available on corporate governance, it could notice that there is lack of evidences especially relating to Sri Lankan context. Hence, we contribute by employing two governance related variables namely, number of audit meetings and gender of the directors in the study as extant literature has not given sufficient attention to these variables. Earnings quality is measured with the discretionary accruals designed through balance sheet approach and eight corporate governance variables were used as independent variables. We collected data from 13 banks and 9 insurance firms, from 2015 to 2018 and employed descriptive statistics and panel regression models to analyze the data. Our findings reveal that, there is a significant relationship between board size, firm size and external audit with earnings quality. The presence of fewer directors in the board, increasing firm size and company is being audited by one of the major three audit firms, has a positive impact on earnings quality of banks and insurance companies in the Sri Lanka. The results have implications for the owners, investors and regulators to be mull over directors and the auditors of the companies in selecting the auditors and the directors to the board of directors.

## 1. INTRODUCTION

There is increasing awareness among investors to invest in companies that have a record of observing practices of good corporate governance. Universally, banking and insurance is a well-regulated industry, and the

governance structure is given serious attention because of the crucial role that banks play in the economy. The motivation of this nature of research comes from the global attention to corporate governance and earnings quality (Campbell *et al.*, 1991; Bahaeddin, 2018).

As per Guo (2012), corporate governance is a set of mechanisms that influences the decisions made by managers when there is a separation of ownership and control. Some of these monitoring mechanisms are the board of directors, institutional shareholders, and operation of the market for corporate control. The importance of this topic is evident from the considerable growth in the empirical literature on corporate governance across accounting, economics, finance, management, and corporate strategy literature. The need for corporate governance has arisen because of the increasing concern about the non-compliance of standards of financial reporting accountability by board of directors and management of corporate inflicting heavy losses on investors.

When it comes to the legal context on corporate governance in Sri Lanka, corporate governance was introduced to the banking sector by the Central Bank of Sri Lanka (CBSL) in 2002. This was introduced as a voluntary code of corporate governance, and in 2007, mandatory corporate governance requirements were issued by the CBSL. These directions are empowered by the Banking Act and the Monetary Law Act in Sri Lanka. The Institute of Chartered Accountants of Sri Lanka (ICASL) and Securities and Exchange Commission of Sri Lanka (SEC) is the pioneering bodies to develop the corporate governance culture in Sri Lanka and they joined hands to introduce "Code of best practice of Corporate Governance". Further, The CSE also involved in this by incorporating corporate governance requirements into listing rules for listed firms (Silva, 2020). Hence, all the listed banks are bound to comply with corporate governance requirements.

As per the code of best practices of Corporate Governance (2017), directions on mandatory corporate governance requirements include, responsibility of the board, composition of the board, criteria to assess the fitness and propriety of directors, management functions delegated by board, Chairman and CEO, Board appointed committee, related part transactions, and disclosure requirements. As outlined by the listing rules of CSE, it mainly highlights the importance of complying with independent directors, non-executive directors, defining independence, audit committee and remuneration committee.

Although there is no universally accepted definition for earnings quality, it is usually defined as the ability of the disclosed results to generate trends allowing predicting future earnings of a company (Maria Jr, *et al.*,

2020; Katz, *et al.*, 2010). In a separate stream, Abed *et al.* (2012) refer to the proportion of income attributable to the core operating activities of a business as the quality of earnings. Therefore, it seems that the characteristic of high-quality earnings is that the earnings are readily repeatable over a series of reporting periods, rather than being earnings that are only reported as the result of a one-time event. In that sense, investors like to see high-quality earnings, since these results tend to be repeated in future periods and provide more cash flows for investors. Corporate governance mechanisms play an essential monitoring role, and that stronger governance structures will reduce the likelihood of earnings management (Abed, *et al.*, 2012). Hence, it can be used as a tool of increasing the quality of the earnings.

Fodio *et al.* (2013) found that board size, board independence and audit committee size are negatively and significantly associated with earnings management, while audit committee independence and independent external audit have a positive relationship with discretionary accruals. However, the criticism of extant researches has been that corporate governance comprises many facts and is not unidimensional.

Some studies indicate a positive impact of corporate governance on earnings quality (Rajeevan & Ajward, 2020), while there is also evidence that corporate governance has a negative effect on earnings quality (Inaam & Khamoussi 2016; Engle, 2005; Niu, 2006). Furthermore, in Sri Lankan context, there are limited studies available to investigate corporate governance and earnings management (Rajeevan & Ajward, 2020; Anwar, & Buvanendra, 2019; Hemathilake & Chathurangani, 2019). Moreover, investigation of these studies eliminated the bank, finance, and insurance sector companies and/or limited to examined a particular sector like manufacturing (see, Karunarathne & Rathwatta, 2018). With this backdrop, the current study investigates the impact of corporate governance on earnings quality for the bank, finance and insurance sector companies which is an important sector in the Sri Lankan economy. Additionally, we take account of number of audit meetings and gender of the directors as measurements of corporate governance that have not been widely used in previous studies, especially in Sri Lanka. That is, we argue on the outcome of the studies conducted to the overall market (Anwar & Buvanendra, 2019; Rajeevan & Ajward, 2020; Lehn, Patro & Zhao, 2009; and Guo, 2012) as it is questionable with the presence of industry specific characteristics that may influence the findings. This has been emphasized by Abdelghany (2005), Lyimo (2014) and Wasiuzzaman, *et al.* (2015) in global context and Wijesinghe and Kehelwalatenna (2017) in Sri Lankan context. With this

backdrop, the objective of this study is to investigate the impact of corporate governance mechanisms on earnings quality of listed banks and insurance companies in Sri Lanka.

The remaining part of the paper is organized as follows. A literature review is discussed in section two, and the methodology adopted in the study is presented in section three. Results and findings of the study are explained in section four. Section five concludes the paper.

## 2. REVIEW OF LITERATURE

A sound corporate governance structure ensures that the management appropriately utilizes their resources in the best interest of absentee owners. This further enhances the fair presentation of a company's financial and operating performance (Lin & Hwang, 2010). Corporate governance is a factor, that determines whether management will engage in earnings management or not. This is because the interests of managers and owners are different to each other (Jensen & Meckling, 1976). In this context, having a proper appointment of board of directors is vital as a mechanism to reduce the conflict between owners and managers (Matteo & Francesco, 2018). With this, we can expect that managers engage in fewer earnings management activities with sound corporate governance mechanisms in the organization.

Study of Zhou and Chen (2004) on earnings management have shown that weak corporate governance is associated with more significant earnings management. The function of the corporate governance formation in financial reporting is to ensure compliance with generally accepted accounting principles (GAAP) and to maintain the credibility of corporate governance mechanisms are expected to reduce earnings management because they provide effective monitoring of management in the financial reporting process (Dabor & Ibadin, 2013). In order to maintain the quality of financial reporting, the selection of the audit committee is essential for bigger entities. In addition, maintaining the objectivity of the audit committee is vital for the quality of earnings (Kent *et al.*, 2016).

The studies on corporate governance have established considerable attention over the past few years to instill confidence in organizations' stakeholders. However, it is required to overlook corporate governance in different levels of status and applicability. For example, Lapsley and Chia (2007) illustrate that auditors' selection is essential, especially when a financial crisis is present.

Lehn *et al.* (2009) found that board size and structure are consistent with company value maximization. Their results suggest that board

structure and size choices are determined by tradeoffs between the incremental benefits and costs. Various studies in different countries address the importance of corporate governance mechanisms. Especially, we can identify that it has always been a growing concern to measure the corporate governance mechanism's impact on firm performance. The board size has a positive relationship with firm performance in large companies in Australia (Kiel, 2003), whereas a negative relationship was recorded in Thailand (Pathan, 2008). Pathan (2008) measured the firm performance by the risk of equity and return on assets. Board characteristics and ownership structure are not necessarily independent of earnings quality. More commonly, higher earnings quality would lead to a robust board structure and ownership structure (Engle, 2005).

Lapsley and Chia (2007) found that if big six audit firms audit a company, there is a reduction in earnings management activities associated with listed companies. This finding implies that auditing the company by big six auditing firms acts as an effective constrain their clients' earnings management activities (Krishnan, 2003). Hence, audit of big firms may lead to improve the quality of profits. Inaam and Khamoussi (2016) identified the audit committee's independence, size, expertise, and adverse relationship with earnings management. The majority of previous research on corporate governance has focused on developed countries with western cultures. More attention has been paid recently to study the impact of corporate governance on firm performance in developing countries (Jaafar, 2014). This is mainly due to the lack of published data and mixed results (Iraya, 2015). Reported earnings management is negatively related to ownership concentration, board size and board independence. At the same time, Waweru (2013) found ownership structure and board independence as the leading corporate governance variables influencing earnings management in Kenya. Fodio *et al.* (2013) found that board size, board independence and audit committee size are negatively and significantly associated with earnings management, while audit committee independence and independent external audit have a positive relationship with discretionary accruals.

Niu (2006) found that overall governance quality is inversely related to abnormal accruals and positively associated with the return-earnings association. These findings suggest that suitable corporate governance mechanisms provide more excellent monitoring of the financial accounting process. In addition, Niu (2006) found that the magnitude of abnormal accruals is negatively associated with the level of independence of board composition.

It is evidenced that board independence, audit committee size, and audit committee independence have an insignificant positive relationship with earnings management while board size and ownership structure have an insignificant negative relationship with earnings management. In addition, in Nigerian context it has concluded that corporate governance structures have not contributed to address the earnings management (Abata & Migiro, 2016). However, the results may differ with the Sri Lankan Banks and insurance firms. Man and Wong (2013) found that corporate governance can reduce the extent of earnings management. Board independence effect on enhancing certain monitoring behaviors of managers. The presence of female directors in the board develops the trust leadership, and most of the time they become risk averse to frauds as well as opportunistic earnings management. Additionally, the Board of Directors with financial exposure can help in incremental control effects on earnings management.

Nwoye *et al.* (2021) revealed that presence of higher number of finance experts in audit committee increases the manipulation of accruals. Also by having higher number of experts with accounting background in the audit committee reduce the manipulation of performance. Further, the findings of this study reveals that insurance companies audited by big four audit firms are having a less earnings manipulation.

Mazzù *et al.* (2015) examined the earnings management and corporate governance of insurance industry in USA after implementing the SOX. The results indicate low or no impact of the change in governance regulation on the relationship between earnings management practices and governance. However, their findings are limited to the insurance sector and they mainly consider CEO compensation as the main factor to drive the earnings management.

In Sri Lankan context, Rajeevan and Ajward (2020) investigated the board characteristics and earnings management by using a common sample from the CSE and it excluded the banking and finance sectors in their study. The exclusion is based on the prior studies and however the importance of the banking sector to the CSE can not under value. Because, it is the sector with highest number of companies and generally it has the highest market capitalisation. (CSE, 2020). In summary, we can identify that there are mixed results regarding the impact of corporate governance of earnings management. The findings of other studies conducted for other countries can not apply directly to Sri Lankan context as the presence heterogeneity among the countries. Mollah *et al.* (2019) identified that their findings varied with the developed and emerging countries, common

and civil law countries, and different-sized banks. Hence, investigation of corporate governance and earnings management is vital. Furthermore, this is intensified as we cannot identify evidence relating to Sri Lankan context, especially in the banking and insurance sectors. The previous studies on corporate governance and earnings management have mainly considered a single proxy to measure the earnings management, which creates doubt on the outcomes of the studies. This is mainly because it has identified the importance of using several measurements rather than confine to a single proxy to measure the earnings quality (Liceran-Gutiérrez & Cano-Rodríguez, 2019; Wijesinghe & Kehelwalathenne, 2017).

### **3. RESEARCH METHODOLOGY**

#### **3.1. Sample, Data and data collection**

This study used a quantitative research approach. The population and sample are identical, whereas 22 publicly quoted banks and insurance companies in Colombo Stock Exchange from 2015 to 2018 were selected for the research. The data were collected from the annual reports of the companies.

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

Strong corporate governance can be inadequate, and weak corporate governance can be adequate. Thus, strong corporate governance does not necessarily imply high earnings quality, and weak corporate governance does not necessarily mean low earnings quality. However, it may be posited that firms with adequate corporate governance, whether weak or strong, will have higher earnings quality than firms with inadequate corporate governance, whether weak or strong (Sivaramakrishnan & Yu, 2006). Based on these arguments and the outcome of the literature review carried out, we can develop the following alternative hypotheses.

- H<sub>1</sub> - There is a significant impact from board size on earnings quality
- H<sub>2</sub> - There is a significant impact from board independence on earnings quality
- H<sub>3</sub> - There is a significant impact from audit committee size on earnings quality
- H<sub>4</sub> - There is a significant impact from audit committee independence on earnings quality
- H<sub>5</sub> - There is a significant impact from firm size on earnings quality

H<sub>6</sub> - There is a significant impact from number of audit meetings on earnings quality

H<sub>7</sub> - There is a significant impact from external audit on earnings quality

H<sub>8</sub> - There is a significant impact from gender of directors on earnings quality

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

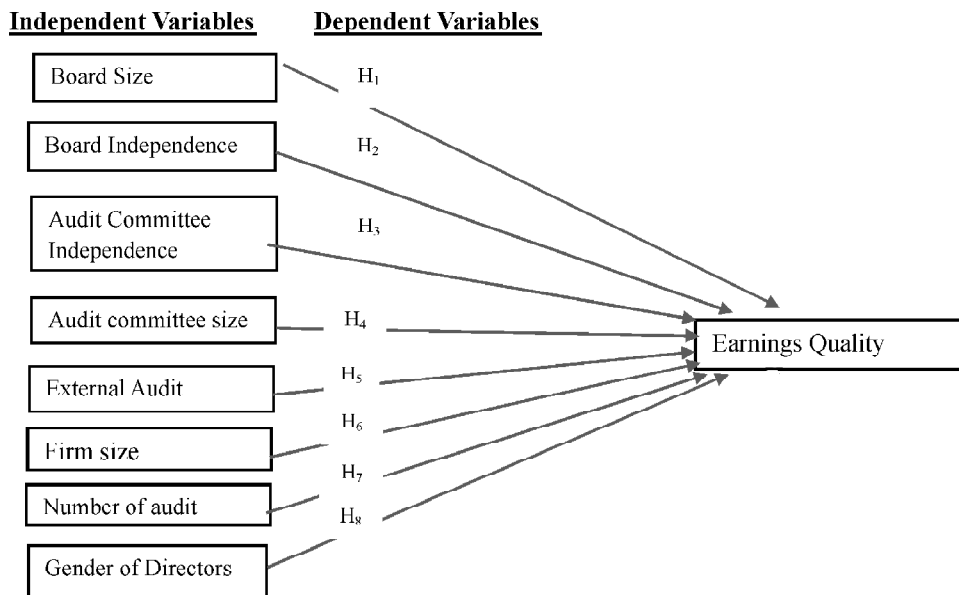


Figure 1: Conceptual Framework

In Chtourou (2001) and Niu (2006), accruals have been intensively used as the proxy for earnings management. Accruals can be measured by Balance Sheet Approach and Cash Flow Approach.

$$TA_t = \Delta A_t - \Delta C_t - \Delta L_t \text{ Balance Sheet Approach} \quad (1)$$

$$TA_t = NI_t - CFO_t \text{ Cash Flow Approach} \quad (2)$$

### 3.3. Measurements of Independent Variables

Following table 1 summarizes the measurements of independent variables with a description of how to calculate. Further, we have given an example of the prior study for each variable.



**Table 1**  
**Measurements of Independent Variables**

<i>Variable</i>	<i>Description</i>	<i>Source</i>
Board Size	Board size is measured as the total number of directors on the board.	(Kiel, 2003)
Board Independence	Board Independence is measured as proportion of non-executive directors to total directors.	(Iraya, 2015)
Audit Committee Independence	Audit Committee Independence is measured as the proportion of non – executive audit committee members to total audit committee members.	Inaam & Khamoussi, 2016
Audit Committee size	Audit Committee size is measured as the total number of audit committee members.	(Fodio, <i>et al.</i> , 2013)
External audit	External audit is captured as a dummy variable. Big 3 audit firms are assigned 1; others are assigned 0.	(Krishnan, 2003)
Firm size	Firm size is the natural logarithm of total assets.	(AL-Dhamari & Ismail, 2014)
Number of Audit meetings	Number of audit meetings is measured as the total number of audit meetings held per year.	Inaam & Khamoussi, 2016
Gender of the Directors	A percentage of total female directors to the total number of directors in the board	(Gull, <i>et al.</i> , 2018)

### 3.4 Regression Model

We have employed the multiple regression models using E View statistical package. The summary of the regression models is as follows.

$$DA = B_0 + B_1 IND_{it} + B_2 BSIZ_{it} + B_3 ACI_{it} + B_4 ACS_{it} + B_5 EAD_{it} + B_6 FS_{it} + B_7 NAM_{it} + B_8 GOD_{it} + U_{it}$$

Where; DA is the earnings quality measured through balance sheet approach ( $DA_{B/S}$ ) or Discretionary Accruals measured through Cash Flow approach ( $DA_{CF}$ )

$B_0$  Constant term

$B$  Coefficient of independent variable

IND Board Independence

BSIZ Board Size

ACI audit Committee Independence

ACS Audit Committee Size

EAD External Audit  
 FS Firm Size  
 NAM Number of audit meetings  
 GOD Gender of Directors  
 $U_{it}$  Error term

Before deriving the final output, we have tested the pre diagnosis tests of the regression analysis. Thereby we tested for Stationary, 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, probability value is greater than 0.05 for both cash flow and balance sheet approach models. Therefore, we employ with random effects model.

## 4. EMPIRICAL RESULTS

### 4.1. Descriptive Statistics

Descriptive statistics (table 2) are broken down into measures of central tendency and measures of variability, or spread. Measures of central tendency include the mean, median and mode, while measures of variability include the standard deviation or variance, the minimum and maximum variables, and the kurtosis, and skewness of the entire independent, dependent and control variables to identify the behavior of the whole variables of the study. Kurtosis measures the degree of sharpness or, in other words, measures the flatness of the distribution of the data series. According to the results of this study, it can be identified that  $DA_{B/S}$ ,  $DA_{C/F}$ , and external audit have leptokurtic distribution because kurtosis values are greater than 03. And Audit committee size, board size, firm size, board independence, number of meetings, and gender of directors have platykurtic distribution since those variables have kurtosis value less than 03.

Many models assume normal distribution; i.e., data are symmetric about the mean. The normal distribution has a skewness of zero. But in reality, data points may not be perfectly symmetric. In here, Audit committee size, Board size,  $DA_{B/S}$ ,  $DA_{C/F}$ , gender of directors and number of meetings are positively skewed and External Audit, Firm size and board independence are negatively skewed.

The correlation matrix suggests that there is no multicollinearity of the study. In general, multicollinearity can lead to wider confidence intervals and less reliable probability values (P values) for the independent variables.

**Table 2**  
**Descriptive statistics**

	ACS	BSIZ	DA_B_S	DA_C_F	EAD	FS	GOD	IND	NAM
Mean	3.965909	9.659091	3087382	3795.148	0.909091	24.85082	0.121167	0.910790	8.375000
Median	4.000000	10.00000	1183.700	1935.915	1.000000	24.70180	0.125000	0.916667	8.000000
Maximum	7.000000	16.00000	26902.02	17999.83	1.000000	27.89606	0.375000	1.000000	19.00000
Minimum	2.000000	4.000000	17.97800	0.675482	0.000000	20.87228	0.000000	0.666667	3.000000
Std. Dev.	1.226610	2.669049	5064.913	4705.645	0.289127	1.771433	0.107402	0.088694	4.194448
Skewness	0.290586	0.135790	3.217623	1.457451	-2.84605	-0.150147	0.226363	-0.671643	0.669911
Kurtosis	2.179753	2.902464	14.17865	3.959629	9.100000	2.241497	1.850593	2.509713	2.365154
Jarque-Bera	3.705409	0.305321	610.0399	34.53097	255.2367	2.440179	5.595689	7.497584	8.059894
Probability	0.156813	0.858421	0	0	0	0.295204	0.060941	0.023546	0.017775
Observations	88	88	88	88	88	88	88	88	88

When there is a perfect or an exact relationship between the predictor variables, it is difficult to come up with reliable estimates of their individual coefficients. Multicollinearity inflates the variances of the parameter estimates, and hence this may lead to a lack of statistical significance of individual predictor variables even though the overall model may be significant. The correlation matrix of the study is as follows.

**Table 3: Correlation Matrix**

	ACS	EAD	BSIZ	GOD	FS	IND	NAM
ACS	1.000000	-	-	-	-	-	-
EAD	-0.300533	1.000000	-	-	-	-	-
BSIZ	0.294835	0.167905	1.000000	-	-	-	-
GOD	-0.013517	0.152133	0.000332	1.000000	-	-	-
FS	0.498533	0.082840	0.498538	0.260051	1.000000	-	-
IND	0.163838	-0.319888	-0.299673	-0.179157	-0.203418	1.000000	-
NAM	0.277306	0.075824	0.306217	0.285793	0.617785	0.108415	1.000000

In addition, the tested results for the Stationary, Normality, Multicollinearity and Autocorrelation and satisfied. For example, value of Durbin Watson test is 1.968795 for model run with net accruals measured through cash flow approach and 1.835504 for model run with net accruals measured through balance sheet approach. After satisfying preliminary requirements, the regression results are presented below.

## 4.2 Regression analysis of DAC/F Model

<i>Variable</i>	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-Statistic</i>	<i>Prob.</i>
C	-14.83846	4.542904	-3.266293	0.0016
ACS	-0.030880	0.182796	-0.168934	0.8663
BSIZ	-0.211928	0.080204	-2.642363	0.0099
EAD	-0.020402	0.683183	-0.029863	0.9763
FS	0.916975	0.159402	5.752588	0.0000
GOD	-0.477140	1.770428	-0.269506	0.7882
NAM	-0.022648	0.056681	-0.399573	0.6905
IND	1.768331	2.369188	0.746387	0.4576

According to the F-statistic the overall model is significant at 1% level. R-squared is the “percent of variance explained” by the model. According to the model output,  $R^2$  is 0.46. In the model, only Board size and firm size are significant at 5% level in discretionary accruals measured through cash flow approach.

## 4.3 Regression analysis of DAB/S Model

<i>Variable</i>	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-Statistic</i>	<i>Prob.</i>
C	-11.79990	2.527738	-4.668164	0.0000
ACS	0.056851	0.146121	0.389072	0.6983
BSIZ	-0.014896	0.065717	-0.226665	0.8213
EAD	1.156129	0.566805	2.039731	0.0447
FS	0.752033	0.132779	5.663790	0.0000
GOD	2.259957	1.479670	1.527338	0.1306
LOGIND	0.371825	1.663646	0.223500	0.8237
LOGNAM	-0.664452	0.402818	-1.649511	0.1030

The F-statistic of the output, indicates that the model is significant at 1% level. According to the model output un-weighted  $R^2$  is 0.5448. It indicates that the model explains 54.48% of the variability of the response data around its mean. In the model, only external audit and firm size are significant at 5% level in discretionary accruals measured through balance sheet approach.

## DISCUSSION AND CONCLUSION

The objective of this study is to examine the impact of corporate governance on earnings quality of listed banks and insurance firms for a period of four

years 2015 to 2018 in Sri Lanka. For this purpose, we have used board size, board independence, audit committee independence, audit committee size, external audit, firm size, number of audit meetings and gender of the directors to measure the corporate governance while discretionary accruals measured through balance sheet approach and cash flow approach were taken as the proxies for earnings management.

The results were generated by using the statistical software of EViews and since this study had two dependent variables, statistical tests have been performed separately for those dependent variables with the independent variables.

In contrary to the expectations of the researcher, the empirical findings suggest that, when considering the model with the dependent variable of discretionary accruals through cash flow approach, which is a proxy for earnings quality, board size (BS) has a significant negative relationship with the discretionary accruals. As the probability value of board size is 0.0099, which is lesser than 0.05, board size influence changes the model significantly. Lehn *et al.* (2009) found evidence that board size and structure are determined in a manner that is consistent with company value maximization.

Further, these findings are consistent with the study of Mollah *et al.*, (2019) which examined the impact of corporate governance on earnings predictability. Predictability of future cash flows was considered in measuring the earnings quality since it is a forward-looking measure of earnings quality.

In the same model, firm size (FS) has a significant positive relationship with discretionary accruals. Coefficient of firm size is 0.9169. As firm size's probability value is 0.0000 which is lesser than 0.05, firm size can influence to change the model significantly.

When considering the model with the dependent variable of discretionary accruals measured through balance sheet approach, which is a proxy for earnings quality, external audit (EA) has a positive but significant relationship with the discretionary accruals. The coefficient of external audit is 1.156129. This describes when the company's external audit is performed by one of main 3 audit firms in Sri Lanka, the impact for discretionary accruals is 1.156129%. Since, the probability value is 0.0447, which is lesser than 0.05, it significantly affects the model. This is consistent with the finding of Krishnan (2003), which implies that audit of big auditing firms leads to constraining the earnings management activities of the client.

In the same model, firm size (FS) has a positive relationship with the discretionary accruals and significant relationship with the discretionary accruals. Coefficient of firm size is 0.752033 which describes when, the firm size changes by 1 discretionary accrual through balance sheet approach will be changed by 0.75%. As firm size's probability value is 0.0000 which is lesser than 0.05, firm size can influence to change the model significantly.

The main objective of study was to examine the impact of corporate governance on earnings quality of listed banks and insurance companies in Sri Lanka by using the cash flow approach and the balance sheet approach. According to the results, board size, firm size and external audit are the influencing factors for earnings quality of banks and insurance companies in the Sri Lankan context.

Since both management and investors are concerned about corporate governance and earnings quality, this research has provided a light on the pathway to discovering positive relationship between the firm size and quality of earnings, similarly the negative relationship between board size and quality of earnings. Other than the above two, external audit has positive relationship with the quality of earnings, although these variables are significant at 5%. So researcher suggests that if an investor is keen on size of the company, he/she should identify the positive relationship between firm size and quality of earnings. Since board size is affecting negatively, reducing number of directors in the board will improve the quality of earnings. When considering the external audit, if the bank or insurance company is audited by one of three major audit firms in Sri Lanka, it will improve the quality of earnings.

The study suffers from certain limitations. The period is limited to 2015 to 2018 and sample is limited to twenty-two banks and insurance companies, which represent the whole population. Hence, it is suggested to further examine the topic of corporate governance and quality of earnings for the other sectors and see whether corporate governance will influence the company's earnings quality. Furthermore, we suggest that future researchers to extend the period and employ more possible proxies to denote corporate governance. Therefore, future studies may need to explore how other aspects of corporate governance impact earnings management. It is suggested for future researchers to explore the same using qualitative methods of measurements, and we recommend examining the same as cross-country studies.

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