



South Asian Journal of Finance

ISSN (Online): 2719-2547 | Journal Home Page: <https://sajf.sljol.info/>

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To cite this article: Jeevakumar J. and Mudalige H.M.N.K. (2024). Audit Quality and Its Impact on the Earnings Management in the Post-COVID Era: Evidence from Sri Lanka, *South Asian Journal of Finance*, 4(1), 1–16.

Audit Quality and Its Impact on the Earnings Management in the Post-COVID Era: Evidence from Sri Lanka

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ABSTRACT

Purpose: The purpose of this study is to identify the impact of audit quality on the earnings management and explore the relationship between audit quality and earnings Management, with the main objective of identifying the impact of audit quality on the earnings management in the post-COVID era. The research utilizes a literature review that spans the recent years, focusing on audit quality-related literature and earnings management literature, such as the utilization of discretionary accruals and a modified version of the Healy's Model.

Design/Methodology/Approach: Audit quality is determined by looking at two proxies: the size of the audit firm and independence. The study was conducted using the data collected from 92 non-financial organizations with a financial year ending in March, during the post-COVID research period of 2019/20 to 2021/22. Descriptive statistics, correlation analysis, and regression analysis were among the methods utilized for analysing the acquired data.

Findings: Although the results are inconclusive, the study suggests that the level of earnings management in Sri Lanka is not significantly influenced by the quality of audit conducted in the country. Therefore, this study concludes that audit quality has no significant impact on earnings management in the post-COVID era.

Originality: This study focuses on the post-COVID years to examine the impact of audit quality on earnings management and the relationship between audit quality and earnings Management, given the limited research conducted in the Sri Lankan context and the inconclusive findings of previous literatures.

KEYWORDS

audit quality, earnings management, audit firm size, auditor independence, Healy's model

JEL CLASSIFICATION

M4

I. Introduction

In the Sri Lankan context, the economic crisis and decline in the capital market have prompted a reassessment of the concepts of audit quality and investor confidence. Failure to deliver high quality audits, could result in a plummet in investor confidence, with potential adverse effects on capital markets and local economies. In recent years, corporate fraud and accounting scandals have triggered significant interest in public company audits (PRADA, 2007). So the quality of the audit plays an important role in the financial markets as a factor that creates the investor confidence is auditor's opinion on the financial statements.

A number of companies collapsed globally and locally as a result of allegations made by employees of those companies (Perera Prabath, 2020) After the scandals and economic events of the past decade, the issue of financial reporting and audit quality is considered as crucial as ever. Also, Previous findings regarding the relationship between audit quality proxies and earnings management have been inconclusive, lacking a firm conclusion. Further, the COVID-19 pandemic has accelerated this discussion, with many audit firms announcing large-scale plans to adopt working from home (WFH) policies. (Causholli, 2022)

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Received: 17 March 2024, Accepted revised version: 18 May 2024

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The residual income of a company is the most essential component of its financial statements since it represents the company's earnings and provides insight into the fundamental financial performance of the organization (Levitt, 1998). According to Deegan (2014), the value of accounting data, such as earnings, was called into severe question in the middle of the 1960s. Despite being merely an accounting datum, earnings are currently considered crucial. Several thinkers and practitioners have proposed substantial improvements to accounting to enhance the utility of financial statement information for decision making. A contentious debate has arisen regarding the profitability of adopting historical cost accounting for profit computation. The studies conducted by Ball and Brown (1968) and Beaver (1968) were significant to demonstrate the value and relevance of accounting information in investor decision-making. Ball and Brown (1968) revealed that investors utilize reported profits to form their estimates and judgments, as evidenced by stock price variation in response to unexpected earnings disclosures. This was done to show that investors use reported earnings. Okolie (2014) emphasizes that profits serve as a signal and driver to resource allocation in the capital market. Hence Remote auditing, which has become more prevalent due to the COVID-19 pandemic, as mentioned above, involves auditors conducting their work from a remote location rather than physically visiting the client's premises. While remote audits offer benefits, such as increased flexibility and efficiency, they also pose challenges, such as limited access to physical documentation and a reduced ability to observe internal controls. Remote auditing could increase the risk of earnings management in the absence of effective monitoring and oversight.

In addition, audit firms and the audit committees of publicly listed companies need to understand the broader elements that influence audit quality and the role it plays in constraining profits management

strategies. This study facilitates a clearer understanding of their role in ensuring the efficient operation of the country's capital market. This study will also aid audit firms and audit committees in becoming more accountable for their commitments and the level of service they provide. Regulators and policy makers, such as the Security Exchange Commission (SEC), Institute of Chartered Accountants of Sri Lanka (ICASL), Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB), need to understand the broader influences and significance of audit quality in earnings management to effectively regulate the quality of audit services and implement necessary mitigation measures. This understanding will enable them to regulate the quality of audit services more effectively and implement necessary mitigation measures. Additionally, there has been limited published research on audit quality and earnings management in Sri Lanka.

Sri Lanka, as a developing nation, has also witnessed several such scandals in the past. The falls of Pramuka Bank, Touchwood Investments, and Golden Key PLC were some of the prominent cases reported. Auditors of such companies were publicly accused, sued, and imprisoned for failing to act ethically and with due care. In this context, this study attempts to address the fundamental issue of whether audit quality influences the earnings management practices by using evidence from Sri Lankan listed firms. . Due to the Scandals and economic events over past decade, the issue of financial reporting and audit quality is considered as crucial than ever. Additionally, previous findings on the relationship between audit quality proxies and earnings management have been inconclusive, failing to yield a firm conclusion. Moreover, the widespread adoption of working from home (WFH) policies, it remains unclear how this emerging work arrangement might audit quality. If auditors are negatively affected by working from home, it could lead to a

reduction in audit quality (RAQ) behavior, consequently impacting overall audit quality negatively. Consequently, the main factors contributing to the research gap and problem justification include remote audit quality in the post-COVID era, inconclusive findings from previous researchers and the scarcity of literature, particularly in developing countries, especially like Sri Lanka. Therefore, the primary objective of this research is to investigate the impact of audit quality on earnings management in Sri Lanka's public listed companies during the post-COVID.

This research paper is structured into five different sections, each contributing to a comprehensive understanding and analysis of the subject matter. The first section of the article serves as an introduction establishing the context and purpose of the study. The second section is dedicated to the literature review and hypothesis development, involving an in-depth examination of existing academic works, scholarly publications and relevant sources of information, from which hypotheses are derived. The third section focuses on the research methodology employed in the study, detailing the approach and techniques utilized. In the fourth section, the findings and discussion are presented, where the results obtained through the research methodology are analyzed and interpreted. Finally, the fifth and final section is the conclusion providing a succinct summary of the main findings of the study.

II. Literature Review

Agency Theory

Agency theory provides a valuable framework to understand the incentives and motivations behind earnings management and the role of audit quality in mitigating these issues. By aligning the interests of principals and agents, high-quality audits can help to reduce agency costs and promote efficient corporate governance. As such, policymakers, regulators, and investors

should prioritize improving audit quality and enhancing transparency in financial reporting (Watts & Zimmerman, 1986). Agency theory refers to ideas and concepts that explain the relationships and interactions between various parties involved in corporate decision making, particularly between the principal (i.e., shareholders) and the agent (i.e., management). According to this theory, conflicts of interest between principals and agents can arise due to information asymmetry, divergent goals, and differing risk preferences. As such, the agent may engage in opportunistic behavior, such as earnings management, to maximize their interests, often at the expense of the principal's interests (Jensen, 1993).

High-quality audits play a crucial role in mitigating the risk of earnings management and other agency problems by providing independent assurance of the reliability of financial statements. This is because auditors are external parties independent of management and possess the expertise to assess the accuracy of financial information. A high-quality audit can increase transparency and reduce information asymmetry, leading to more accurate financial reporting and help align the interests of principals and agents (Cahan, 2008).

Management hegemony theory

Management hegemony theory also suggests that management's control over the organization extends beyond the workplace and into broader society. This is because organizations are embedded within larger societal structures, and their practices and values can influence broader social norms and expectations. For example, management's emphasis on individualism and competition within the organization can reinforce similar values in the broader society, perpetuating inequality and social stratification (Gerayli, 2011)

Furthermore, management's dominant influence within the organization can pose

challenges for auditors in maintaining independence and objectivity. If management exerts undue influence over auditors or engages in practices compromising their independence, auditors may be less inclined to identify and report instances of earnings management or other financial irregularities. Consequently, this can result in diminished audit quality and heightened risks of financial reporting errors or misstatements (Felo, 2011).

The management hegemony theory highlights the potential challenges auditors face in detecting and preventing earnings management within organizations. The theory suggests that auditors must maintain their independence and objectivity in the face of pressure from management and other powerful actors within the organization.

Audit Quality

The concept of audit quality emphasizes that its evaluation is a matter of subjectivity, as stated by Knechel et al. (2013). Those who use the audited financial statements evaluate the quality of the audit based on its accuracy in detecting substantial misstatements. In contrast, auditors evaluate it based on the audit process that was utilized. According to Lin and Tepalagul (2015), auditors must be independent both in fact and in appearance. The existing body of research identifies four threats to audit independence: the importance of the client, the provision of services other than auditing, the length of time an auditor has been employed, and client affiliation with audit firms. According to the findings of a study conducted by Ghosh, Kallapur, and Moon (2009), high levels of client importance have a more significant negative influence on investor opinion than a large percentage of non-audit fees.

The definitions of audit quality proposed by various academics predominantly revolve around two aspects: the auditor's capability of detecting misstatements, as well as the auditor's expertise, technical abilities, and independence. According to Manita and

Elommal (2010), the descriptions of audit quality primarily focus on the auditor's quality, with the auditor being the central figure in each description. In addition, the proxies or indicators that are utilized to evaluate the audit quality are also auditor centric. As Becker et al. (1998), DeAngelo (1981), and Palmrose all point out, that the most common proxies are auditor size and auditor independence. The difference in quality that exists between large and smaller audit firms is often used as the basis for determining the size of the auditing company. Audit fee was used as a proxy to gauge audit independence based on the argument of economic bond and as a measure of audit effort (Higher effort higher fee) (Becker, 1998). It is evident that the proxies are highly input based. DeFond and Zhang (2014) highlight that input-based proxies represent the observable aspect of audit quality as perceived by clients. Furthermore, it is challenging to evaluate any quality improvements in terms of audit fees. Amidst these disadvantages, they are still employed in research primarily due to the easy and free access to relevant data.

Earnings Management

Earnings management is defined as "managers using discretion in financial reporting and in structuring transactions to alter financial reports either to mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers," by Healy and Wahlen (1999). Earnings management, according to D. Fields, Z. Lys, and Vincent (2001), "occurs when managers exercise their discretion over accounting statistics with or without limits. Such discretion may be either opportunistic or aimed towards enhancing business value. These viewpoints can be distinguished from one another, but, by management intent because management intent cannot be seen. Due to the adaptability of accounting laws and policies, managers and accountants have access a wide variety of strategies and

tactics for manipulating numbers, records, and statements. Earnings management is a strategy that involves choosing or deviating from accounting principles to influence financial occurrences. There are two earning management approaches (Ronen J., 2008).

Earnings management, according to D. Fields, Z. Lys, and Vincent (2001), "occurs when managers exercise their discretion over accounting statistics with or without limits." Such discretion may be either opportunistic or aimed towards enhancing business value. These viewpoints can be distinguished from one another, but, by management intent because management intent cannot be seen. Earnings management is typically characterized as a destructive phenomenon in empirical study definitions. Although there may be significant differences between the definitions, they all point out the characteristics of practices that affect earnings.

Impact of Audit Firm Size on Earnings Management

Antle et al. (2006) discovered that several other research have demonstrated a substantial inverse association between the size of an audit company and earnings management. This assumes that larger audit firms are more motivated to identify financial irregularities since they are exposed to more scrutiny from authorities and stakeholders. According to Watts and Zimmerman (1981), partners at larger businesses are subject to a more stringent level of oversight of activities. Companies have a strong incentive to avoid failing audits to safeguard their brand and image and stay out of legal trouble. The repercussions of a significant auditing failure, such as the downfall of Arthur Andersen, might put the company in jeopardy of going out of business. This indicates that more prominent audit companies are likely to be more careful in discovering and reporting any possible earnings management methods by their customers, to avoid such failures. This is

because larger audit firms have more clients to monitor.

According to the findings of the research by Rusmin (2010), there is a deteriorating connection between audit quality and profits management in Singaporean listed companies. According to the findings of the study, earnings management was substantially less prevalent in businesses audited by industry specialists and the Big 4 audit firms. A study examined 367 Taiwanese businesses that had just gone public showed similar results. The researchers concluded that better quality auditors (i.e. the main five that operate in Taiwan) were able to limit earnings management (Chen, 2005).

In contrast various research studies have found no significant relationship between the presence of big audit firms and earnings management activities. For instance, Piot and Janin's (2007) study of 102 non-financial companies in France revealed that, having a Big Five auditor did not affect earnings management practices. Similarly, Rrahman and Ali (2006) discovered no significant correlation between big audit firms and earnings management among the top 100 companies on Bursa Malaysia Main Board. Sun, Liu, and Lan (2011) also confirmed the absence of a meaningful connection between big four audit firms and discretionary accruals. Ching et al. (2015) conducted a study on Malaysian public listed companies and found that the size of the audit firm did not have any impact on earnings management. However, the study observed a discrepancy in its findings compared to previous research, which could be attributed to the distinctive audit landscape of Malaysia. The study emphasized that Malaysia's institutional environment lacks strict regulations and oversight over audit firms, which did not incentivize firms to improve their audit quality. This finding suggests that the impact of audit firm size on earnings management may vary depending on the regulatory environment of the country.

H₁: Audit firm size has a significantly negative impact on the earnings management.

Impact of Auditor's Independence on Earnings Management

According to the findings of several studies, higher audit fees are linked to lower levels of earnings management, indicating increased efforts to enhance audit quality. However, no research has found a positive correlation between audit independence and earnings management, this has been consistent across all studies. According to the findings of a study conducted in 2007 by Srinidhi and Gul, there is a positive link between audit fees and accrual quality, showing a negative association with earnings management. Similarly, research conducted by Habbash in 2010 revealed a significant inverse relationship between audit fees and earnings management in the UK. More specifically, the researchers found that as audit fees increased for a client, there was a corresponding decrease in earnings management.

In contrast, the research conducted in 2002 by Chung and Kallapur looked at 1,871 businesses in 54 different industries to evaluate whether client significance ratios (total fees, audit fees, and non-audit fees) were connected to discretionary accruals. They discovered no statistically significant association between any of the client importance ratios and the discretionary accruals, which included the audit fees.

In a study conducted in 2015 by Ching et al., which examined publicly traded Malaysian businesses from 2008 to 2013, the researchers reached the same conclusion: there was no significant relationship between audit fees and profits management. Compared to the United States and the United Kingdom, the auditing environment in Malaysia is comparatively weak. This lack of association was ascribed to this fact. Overall, the findings of both studies point to the conclusion that the relationship between client importance ratios and earnings

management may not be as straightforward as previously thought. Instead, the nature of this relationship may be contingent on factors such as the audit environment of a particular nation or region.

H₂: Auditor independence has a significantly negative impact on the earnings management.

Hypothesis Development

According to the findings of several studies, increased audit fees are associated with decreased levels of earnings management, which suggests that more work is invested into ensuring that audit quality is improved. No research has identified a positive correlation between audit independence and earnings management. This finding has been consistent across all studies. According to the findings of a study conducted in 2007 by Srinidhi and Gul, there is a positive correlation between audit fees and accrual quality, showing a negative association with earnings management. In a similar vein, the research that was conducted by Habbash in 2010 found that there is a significant inverse relationship between audit fees and earnings management in the UK. More specifically, the researchers found that as audit fees increased for a client, there was a corresponding decrease in the amount of earnings management that was taking place. The research conducted by Lin and Hwang conducted in 2010 supports the hypothesis that increased effort by auditors result in long working hours, and the level of audit fees, ultimately resulting in a decrease in earnings management. In other words, their findings imply that there is a positive relationship between the amount of effort put in by auditors, the number of working hours, and the level of audit fees, which ultimately leads to a reduction in earnings management. This is the case because their findings suggest that a positive relationship exists between these three factors.

Also several other research have demonstrated a substantial inverse association between the size of an audit

company and earnings management. This assumes that larger audit firms have a higher motivation to identify financial irregularities since they are exposed to more scrutiny from authorities and stakeholders. According to Watts and Zimmerman (1981), partners at larger businesses are subject to a more stringent level of oversight about their activities. Companies have a strong incentive to avoid failing audits so that they may safeguard their brand and image and stay out of legal trouble. The repercussions of a significant auditing failure, such as the downfall of Arthur Andersen, might put the company in jeopardy of going out of business. This indicates that bigger audit companies are likely to be more careful in discovering and reporting any possible earnings management methods by their customers, to avoid such failures. This is because larger audit firms have more clients to monitor.

According to the findings of research carried out by Rusmin (2010), there is a deteriorating connection between audit quality and profits management in Singaporean listed companies. According to the findings of the study, earnings management was substantially less prevalent in businesses that were audited by industry specialists as well as the Big 4 audit firms. A study that looked at 367 Taiwanese businesses that had just gone public showed similar results. The researchers concluded that better quality auditors (i.e. the main five that operate in Taiwan) were able to limit earnings management (Chen, Lin & Zhou 2005). These findings were further supported by research carried out in the United States by Becker et al. (1998), Krishnan (2003), and Jordan, Clark, and Hames (2010); in the United Kingdom by Gore, Pope, and Singh (2001); in Iran by Gerald, Yanesari, and Ma'atoofi (2011); in Nigeria by Okolie and Izedonmi (2013); and in Europe by Tendeloo and Vanstraelen (2008); as well as in a number of other studies (Gul, Sui & Dhaliwal 2006; Lin & Hwang 2010).

Overall, all these findings support the conclusion that auditors of higher quality are more effective in mitigating earnings management. Hence as mentioned above, the following hypothesis are developed for this research study,

H₁: Audit firm size has a significantly negative impact on the earnings management.

H₂: Auditor independence has a significantly negative impact on the earnings management.

III. Methodology

This study deals with a large amount of data (more scientific) and a large sample (representative of the population), along with clearly identified research questions and objectives and a structured data collection method from the secondary source. Therefore, the quantitative research approach is deemed more suitable method than the qualitative design for this empirical study of audit quality impact on earnings management.

Data Collection

Secondary data were utilized for the analysis in this study. Information was gleaned from the public annual reports of the sample corporations that were found on the CSE website. The Statement of Financial Situation, the Statement of Profit and Loss and Other Comprehensive Income, the Notes to the Financial Statements, Disclosures from the Audit Committee, and the Audit Report are important to this study for the years from 2019/2020 to 2021/2022.

This study focuses only on the non-financial public listed companies and ignores the financial industry due to the unique financial attributes and strict rules and regulations governing the financial public listed companies. As there are large number of non-financial public companies listed in CSE, this study includes only 92 non-financial companies whose fiscal years conclude on March 31st by excluding

December 31st. This study has used stratified random sampling to select 92 businesses as the sample based on the weighted average of the GIC industry groups. This method ensures that the sample size accurately represents the population. As its sample period, the research looks at the most recent post- COVID three years, beginning with the fiscal year 2019/2020 and to the fiscal year 2021/2022.

Data Analysis Techniques

To ensure the validity and reliability of the results and to measure the impact of audit quality on the earnings management, this study utilized methods such as descriptive statistical analysis, correlation analysis, and regression analysis when analyzing the data using SPSS statistical software package. These methods were used to measure the impact of audit quality on earnings management. Descriptive statistics will be applied to each variable under the study, including mean, median, standard deviation,

maximum and minimum values. Correlation analysis will be conducted on a pairwise basis to examine the relationship between all variables, utilizing . Pearson correlation coefficients. This analysis aims to identify significant and robust correlation between the variables. Additionally, regression Analysis will be utilized to assess the impact of the audit firm size and auditor independence on Earnings management.

Conceptual Framework

In this study, the variables that are considered independent are the proxies of audit quality, and the variable that is considered dependent is discretionary accrual, which is a proxy for earnings management. As a control variable, this study considers other characteristics that influence the earnings management process. These other elements include the size of the board, the independence of the board, and CEO duality. Therefore, the conceptual Diagram of the study is given below.

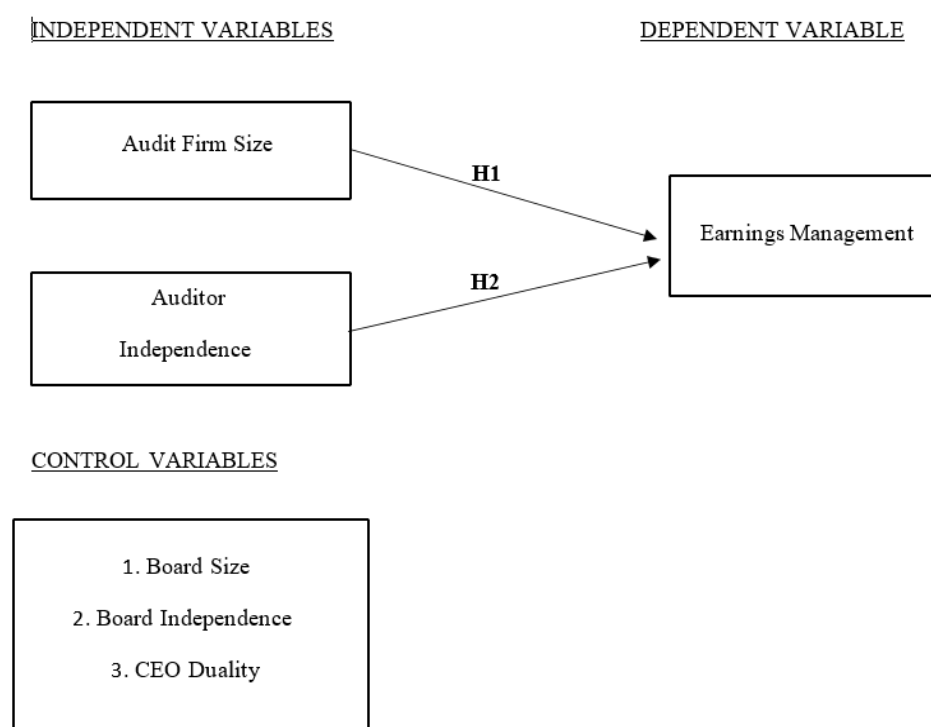


Figure 1. Conceptual framework of the study

Operationalization of the variables

Earnings management which is measured in terms of discretionary accruals is calculated through the Absolute value of discretionary accruals of company *i* for year *t* using modified Healy's Model. Audit size is 1 if the auditor is a member of the Big Four, "0" otherwise and Audit Independence measured through the natural logarithm of audit fees of the company *i* for year *t*. The control variables such as board size, Board

Independence, and CEO Duality are measured using the total number of board members of the company *i* for year *t*, the Ratio of independent non-executive directors in the board to total board members of the company *i* for year *t*, and "1" if the roles of the CEO and Chairman are combined, if not "0" respectively.

management variables. The mean, minimum, maximum, median, and standard deviation are calculated. The first variable, Audit Size, is a categorical variable that takes values of either 0 or 1. The mean value of 0.783 suggests that most of the sample had a large audit size which the big four audit firms' audit. Audit Independence is a continuous variable that ranges from 5.324 to 8.654. The mean value of 6.800 suggests that the average level of audit independence was relatively high in the sample. The mean value of 9 directors indicates that the average board size was relatively large. However, in terms of Board Independence, on average only 37% of the Board comprises of independent nonexecutive directors with the maximum being of 65.85% of the Board. CEO Duality, is also binary variable that takes values of either 0 or 1. The mean value of 0.062 indicates that CEO duality was relatively uncommon in the sample

IV. Findings and Discussion

Descriptive statistics

To provide a general overview of the sample, descriptive statistics are used to analyze the audit quality and earnings

Table 1. Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Audit Size	0.000	1.000	0.783	0.413
Audit Independence	5.324	8.654	6.800	0.719
Absolute Discretionary Accruals	2.212	11.613	7.662	2.109
Board Size	3.000	18.000	8.699	2.626
Board Independence	0.200	0.6585	0.366	0.149
CEO Duality	0.000	1.000	0.062	0.241
Valid N (listwise)				

Correlation Analysis

Based on the correlation analysis, it was found that neither Audit Size nor Auditor Independence exhibited a significant relationship with earnings management. Similarly, the regression analysis indicated that there is no significant impact of audit quality on earnings management. Although the results of the descriptive statistics

highlight a higher compliance with corporate governance rules, an insignificant correlation is found between the board size, CEO duality, and earnings management proxies. This implies that even though businesses comply with these corporate governance rules, the mechanisms are ineffective at limiting the earnings management.

Table 2. Correlation Table

	Audit Size	Audit Independence	Discretionary Accruals	Board Size	Board Independence	CEO Duality
Audit Size	1					
Audit Independence	0.153 -0.381	1				
Discretionary Accruals	0.113 0.06	-0.059 0.329	1			
Board Size	0.004 0.827	.15** 0.001	0.185 0.897	1		
Board Independence	-0.085 0.161	-0.083 0.085	0.07 0.088	-0.004 0.945	1	
CEO Duality	-0.084 0.163	-0.031 0.607	-0.035 0.564	-0.051 0.398	0.089 0.14	1

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

Looking at the correlation table, Audit Size has a weak negative correlation with Discretionary Accruals ($r = -0.113$, $p < 0.05$), suggesting that larger audit firms may be associated with lower discretionary accruals. Audit Independence has a weak negative correlation with Discretionary Accruals ($r = -0.059$, $p > 0.05$), indicating that there may not be a significant relationship between audit independence and

discretionary accruals. Hence, based on the results, it is evident that in both hypotheses of the study are unsupported. Therefore, these findings indicate that audit quality has no significant impact on the earnings management in Sri Lankan listed companies.

Regression Analysis

In a study carried out, Judge et al states that random effect model is more suitable for the research study when characterized by fewer time series units and higher cross-sectional units. (Habbash, 2010). This study also consists of time series of three years with cross-sectional units of 92 companies, the random-effects model is much suited. As Chi-Sq. statistic is greater than 0.05, null hypothesis is accepted and the random effect model is appropriate for analysis.

The following model summary presents a regression analysis that investigates the impact of several independent variables and control variables (predictors) on the earnings management (the dependent variable). The

predictors included in the model are audit independence, audit size, CEO duality, board independence, board size, and a constant term.

The model summary table shows that the regression model has a co-efficient of determination (R-squared) of 0.577, indicating that only 57.7% of the variability in earnings management is explained by the predictors included in the model. The adjusted R-squared value of 0.553 suggests that the model is good fit for the data, as it accounts for a relatively large proportion of the variability in earnings management once the number of predictors is considered.

Table 3. Model Summary

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
1	.240a	0.577	0.553		0.1903775

a. Predictors: (Constant), CEO Duality, Audit Independence, Audit Size, Board Independence, Board Size

The ANOVA table provides statistical results of an analysis of variance (ANOVA) for the regression model concerning the study Impact of Audit Quality on Earnings Management. The table summarizes the sources of variation in the model and their significance, and the F-test is used to evaluate whether the overall regression model is significant.

The F-test is a statistical test that compares the ratio of the variance explained by the

model to the variance not explained by the model. In this case, the F-value is 3.308, which indicates that the model is statistically significant at the 0.05 significance level. This means that at least one of the predictors in the model is significantly related to the dependent variable.

Table 4. ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.599	5	0.120	3.308	.006b
Residual	9.786	270	0.036		
Total	10.385	275			

a. Dependent Variable: Absolute Discretionary Accruals

b. Predictors: (Constant), CEO Duality, Audit Independence, Audit Size, Board Independence, Board Size

The coefficient table represents the results of a regression analysis investigating the impact of audit quality on earnings management, with Absolute Discretionary Accruals (ADA) as the dependent variable. The table provides information on the unstandardized and standardized coefficients, t-values, and significance levels (p-values) of the independent variables in the model.

The results suggest that, after controlling for other factors, Board Size and Board Independence have a significant positive impact on ADA. The coefficients for these variables are 0.012 and 0.162, respectively, with standardized coefficients of 0.163 and

0.124, respectively. This indicates that a one-unit increase in Board Size or Board Independence leads to a corresponding increase in ADA. On the other hand, the coefficient for Audit Size is negative, but not statistically significant, with a coefficient of 0.044 and a p-value of 0.119. This suggests that larger audit firms may

have a slightly higher impact on ADA, but the effect is not strong enough to be statistically significant. Also, audit Independence and CEO Duality have negative coefficients, but they are also not statistically significant. This indicates that these factors may not significantly impact on ADA in the model. Overall, the results suggest that Board Size and Board Independence are essential factors in explaining the variation in ADA, while Audit Size, Audit Independence, and CEO

Duality does not have a significant impact on earnings management in the model. However, it is essential to note that these results may not necessarily generalize to other contexts or populations, and further research is needed to confirm these findings.

Table 5. Coefficient

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	-0.020	0.106		-0.192	0.848
Audit Size	-0.044	0.028	-0.094	1.565	0.119
Audit Independence	-0.008	0.013	-0.036	-0.592	0.554
Board Size	0.012	0.004	0.163	2.681	0.008
Board Independence	0.162	0.078	0.124	2.085	0.038
CEO Duality	-0.025	0.048	-0.031	-0.517	0.606

a. Dependent Variable: Absolute Discretionary Accruals

Regression Model

The regression formula for the model of this study:

$$\begin{aligned} \text{Absolute Discretionary Accruals} = & -0.020 - \\ & 0.044(\text{Audit Size}) - \\ & 0.008(\text{Audit Independence}) + \\ & 0.012(\text{Board Size}) + \\ & 0.162(\text{Board Independence}) - \\ & 0.025(\text{CEO Duality}) \end{aligned}$$

The key findings of the research study are to identify the relationship between audit quality and earnings management. As audit quality and earnings management are unobservable, this study used two proxies to measure the audit quality. Earnings management was also measured using discretionary accruals as per Healy's model. Based on the correlation analysis, Audit Size and Auditor Independence did not report any significant relationship with earnings management. According to the regression analysis there is no significant impact of audit quality on earnings management.

The findings of Chung and Kallapur (2003), Maijoor and Vanstraelen (2006), Piot and Janin (2007), Yasar (2013), and Ching et al (2015) are all supported by the findings of

this study. Recent literature also suggests that the absence of an efficient system for monitoring and overseeing the auditors results in an insignificant correlation between audit quality and earnings management. Although the results of the descriptive statistics highlight a higher compliance with corporate governance rules, an insignificant correlation is found between the board size, CEO duality, and earnings management proxies. This implies that even though businesses comply with these corporate governance rules, the mechanisms are ineffective at limiting the earnings management.

Conclusion

This study's findings concludes that the audit quality does not have a significant impact on the earnings management in the Sri Lankan listed companies. This study also provides evidence for the insignificant impact of audit quality over the earnings management in Sri Lankan listed companies and offers empirical support to regulatory bodies by highlighting the need for strong regulation and ongoing oversight to affect

the standard of audit in Sri Lanka. It also emphasizes the insufficiency of data on audits of publicly listed companies, which limits the ability to conduct studies on audit quality. The study relied solely on quantitative measures to assess the impact of audit quality on earning management. While this approach can provide valuable insights, it may not capture the full range of factors that influence earnings management or the complexity of the relationship. While the present study on the impact of audit quality on earnings management in the post-COVID era with a sample of 92 companies using a quantitative methodology provides valuable insights, several avenues for future research can build upon and expand the study. Additionally, future research could use a mixed-methods approach combining quantitative measures with qualitative data to provide a more nuanced understanding of the factors influencing earning management. It could also consider the impact of other potential factors that may influence earning management, such as company culture, management incentives, or external pressures. This would allow for a more comprehensive understanding of the complex relationship between audit quality and earning management and could provide insights into ways to mitigate the negative effects of earning management.

Finally, future research could consider the impact of changes in regulations or economic conditions on the relationship between audit quality and earning management. This would allow for a better understanding of how the relationship between audit quality and earning management may vary over time and in different regulatory environment.

Theoretical Implication

The existing theories related to scope of audit quality, impact of audit quality on the degree of earnings management that have been used in previous work. While, popular proxies have been used to measure the unobservable audit quality and earnings management, the results of the study suggest

some questions about the applicability of some of these proxies. This study also provides evidence for the insignificant impact of audit quality over the degree of earnings management in Sri Lankan listed companies.

Practical Implication

The study offers empirical support to regulatory bodies by highlighting the need for strong regulation and ongoing oversight to enhance the quality of audits in Sri Lanka. The study also emphasizes the inadequacy of data on audits of publicly listed companies, which limits the ability to conduct studies on audit quality. To increase transparency, regulatory bodies could enhance the disclosure requirements related to audits, including details such as audit hours spent, non-audit services provider, and related fees.

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