

# THE ROLE OF CORPORATE GOVERNANCE IN ENSURING THE QUALITY OF EARNINGS: EMPIRICAL EVIDENCE FROM THE EMERGING MARKET

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## Abstract

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The separation of decision-making and risk-bearing function in a dispersed ownership structure offers a possibility for the opportunistic conduct of managers (Shleifer & Vishny, 1997). Hence, it necessitates a proactive governing mechanism for the protection of shareholders as well as stakeholders' interest in an organization (Xie et al., 2002). The pivotal objective of the paper is to analyze the effectiveness of corporate governance (CG) in reducing earnings management practices in listed Indian firms. The sample of 270 listed Indian firms in the National Stock Exchange of India (NSE) throughout 9 years from 2007–2008 to 2015–2016 was analyzed using the SmartPLS. From the major findings of statistical analysis using path coefficients, it has been observed governance through ownership and board committees (audit, compensation risk committees) is statistically insignificant in controlling earnings management (Biswas et al., 2022). In addition, the results revealed that board structure, activities, characteristics, and environmental, social, and governance (ESG) disclosures have a significant negative impact on discretionary accruals measured through the modified Jones model.

**Keywords:** Earnings Management, Corporate Governance, Corporate Finance, Investor Protection

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## 1. INTRODUCTION

Earnings management (EM) is a euphuism known by different names like creative accounting, income smoothing, accounting makeup, or cooking accounting books. It is the process of using innovative and deceptive accounting *modus operandi*

to distort financial communication. The motivating forces fundamentally comprise individual incentives, performance-based pay, reimbursement from shares and share options, job safety, individual contentment, cover-up scams, tax management, management buyouts, debt agreement, politically motivated impetus, and behavioral bias of managers.

The cosmetic makeup of financial communication is done to delude stakeholders about the entity's original performance or to influence contractual outcomes, perceptions that depend upon reported accounting numbers. Conflict of interest between agent and principal explained in agency theory is a perfect setting for earning manipulation. The subject was addressed and elaborated to length and breadth by Jensen and Meckling (1976), Eisenhardt (1989), Shleifer and Vishny (1997), and Booth and Schulz (2004). They described how the alliance of incentives and asymmetric information has power over the decision-making process. Schipper (1989) and Healy (1985) supplemented the view by adding that managers of firms exploit loopholes in accounting conventions and concepts under accrual-based accounting, discretionary accruals empower management to determine the magnitude and timing of certain period-ending accruals. Under these aforesaid arrangements, accounting prudence can result in earning exploitation or the shifting of earnings from one period to another (Healy, 1985; Schipper, 1989). According to Schipper (1989), EM happens when managers intervene in the peripheral reporting practice to obtain some secretive gain. Various time-tested innovative techniques like big bath, cookie jar, changing accounting treatment for particular periods, and revenue and expense recognition methods are employed to make up accounting figures (Healy, 1985; McVay, 2006).

In the recent past accounting frauds exposed in financial markets around the globe corroborated the continued existence of a moral hazard and ethical dilemma, thus swelling the significance of transparency and reliability of the financial announcement transmitted to financial markets. After the Enron bankruptcy IT crown jewel of India, Satyam Computer Services Ltd turned India's Enron and the catastrophe of the Indian financial system. This gained the attention of regulatory authorities to tighten the clutch through good governance. In addition, it is largely perceived that a fragile governance mechanism possibly will provide scope for managers to serve their own welfare, which is the symptom of a serious decay in business ethics and a threat to the interest of stakeholders as well. Burgstahler and Eames (2006) stated that countries with potent legal setups and institutional arrangements lead to less earning manipulation. Mohd Ali et al. (2008) documented that ownership structure also determines earnings quality. Moreover, in general, board composition and characteristics and in particular and audit and other committee composition can influence the EM (Fama & Jensen, 1983; Klein, 2002; Abbott et al., 2004; Agrawal & Chadha, 2005; Kamran & Shah, 2014). While several studies examine timing and motivation for managers to manage earnings, the focus was mainly on the incentives of EM like compensation contracts (Healy, 1985) signal manager's private information (Louis & White, 2007), correlate with analysts' forecasts (Burgstahler & Eames, 2006). These studies generally focus on the influence of institutional controls such as the role of the board of directors, the role of external auditors, and the role of competencies in curbing EM. More or less corporate governance (CG) mechanism could be an effective tool in curbing EM practices. The fiduciary

duty of corporate boards is to make sure that a corporation is operating in the enduring interests of the shareholders (Monks & Minow, 2004). The important board functions are monitoring management and providing constructive acquaintances and professional advice. The efficiency in discharging these duties increase with the increase in size, independence, and appropriate diversification. Board activities like the frequency of meetings and the presence of members therein can also discourage the use of unethical tools to smooth the earnings according to the whims of the market. Delegation and distribution of the broad task to different subcommittees can prove more effective in controlling the use of cosmetic accounting techniques. Moreover, the audit committee has a key role to play, its composition like size independence and leadership determine the extent of accuracy, originality, and integrity of financial communication and thus can play an important role in stifling cooking accounts and financial books. Different ownership structures like managerial ownership on the premises of agency theory provide fewer incentives than firms having less managerial ownership. On the other hand, family-owned or concentrated ownership firms have a higher degree of control over the board and management to distort financial communication according to their whims and desires. Similarly, institutional and foreign ownership fetches professionalism, activism, and cultural diversification in ownership and board through their nominee directors which ultimately will have relevance in controlling the window dressing of accounting figures. Disclosure boosts the transparency mechanism hence any distortion of accounting figures would, therefore, be more easily detected by shareholders of companies. Richardson (2006) stated that the magnitude of EM increases with asymmetric information. Thus, supplementary disclosures about governance and corporate social responsibility will deter managers to use different techniques to report fancy figures to stakeholders. Thus overall CG mechanism can have a significant impact on controlling the powers of management to mislead shareholders by providing cooked information about the affairs of the firm. The study of Kwon et al. (2022) indicated that the purpose of the Sarbanes-Oxley (SOX) Act of 2002 was to change corporate behavior to improve reporting process in a developed economy like the US. The results of the study by Kwon et al. (2022) further show how regulatory amendments have an effect on equal accrual and real EM in the context of developed economies like the US.

In the Indian context, few attempts have been made to assess the effect of quality governance mainly audit committee structure on EM (Ghosh & Moon, 2010; Busru & Shanmugasundaram, 2017). A few studies have analyzed the perception of auditors regarding EM (Jaiswal & Banerjee, 2010; Kaur et al., 2021). While another thread of research has focused on how corruption and other EM techniques are surviving in the developing Indian economy. To the best of our knowledge, there are very less elaborative empirical studies that evaluate CG expansively in determining the quality of earnings in Indian listed firms (Biswas et al., 2022). India is a different corporate setting than developed entities with weak legal investor protection in listed

companies to the problems of corruption and an extreme political influence in public sector undertakings. Thus, it would be an interesting research question to probe the extent of the usefulness of the CG mechanism in diminishing the EM practices and enhancing earnings quality in Indian listed firms. Partial least square modeling is applied to support the empirical analysis which is very novel and is at the infancy stage to be implemented in management and finance research. This study will provide fascinating insights into the subject of the effectiveness of the governance system in India.

The remainder of the paper is structured as follows. Section 2 consists of a literature review based on. Section 3 presents the methodology, followed by the results and their discussion in Section 4 and Section 5, respectively. Section 6 concludes the paper.

## 2. LITERATURE REVIEW

The shareholders entrust the task of managing, rewarding, and replacing managers, as well as authorizing key strategic projects, to the board of directors. It, thus, plays a significant role in the general overseeing of the organization and the monitoring of senior management in particular (Jensen & Meckling, 1976; John & Senbet, 1998). Thus, the board of directors is a crucial aspect of CG and is regarded as the main internal mechanism in eliminating agency conflicts, either between managers and shareholders or between majority and minority. The CG research indicates that factors like board size, independence, chairman powers, board diversity, and active engagement can influence the effectiveness with which boards oversee the performance of business managers (John & Senbet, 1998; Biswas et al., 2022). Board size impacts the scope of knowledge, the span of control, and the efficacy, all of which typically rise with its size and so can have many effects on EM (Sanchez-Ballesta & Garcia-Meca, 2007; Shah et al., 2009; Garcia-Meca & Sanchez-Ballesta, 2009). The independent directors (Shah et al., 2009), non-executive directors (Beasley & Salterio, 2001), and institutional directors are seen to be impartial professional monitors, hence decreasing the likelihood of fraudulent EM activities. Contrary to the notion of coordination complexity and greater communication costs in large boards, and assuming governance system compliance in letter and spirit, the following hypothesis is formulated:

*H1: The earnings management is lower in boards with a structure characterized by large board size; more independent and non-executive directors.*

Peasnell et al. (2005), following the expertise hypothesis, determined that the average tenure of non-executive directors on the board had a negative effect on the degree of EM. The constant exposure of outside board members to the firm's business allows them to become more familiar with its procedures and processes. Governing many boards simultaneously enables them to build superior governance skills (Marrakchi Chtourou et al., 2001). Further diversity on the board, particularly of gender and age, can considerably impact earnings quality since female and older directors are more likely to adhere to ethical standards and rules (Ittonen et al., 2013). Srinidhi et al. (2011) and Biswas et al. (2022)

revealed substantial evidence that S&P enterprises with a greater proportion of women on the board of directors report superior earnings. The concept driving the formulation of the following hypothesis is as below:

*H2: Experienced, diversified, and diluted CEO position boards have a significant negative impact on earnings management.*

A recent academic study has shown that the majority of the board's responsibilities are assigned to committees such as audit, nomination, remuneration, and risk. Consequently, their size, makeup, activities, and leadership will determine the extent of their efficacy and operation. The remuneration committee is anticipated to eliminate the conflict of interest between those who establish pay policies and those who profit from them, who, under the asymmetric knowledge paradigm, may attempt to boost their incentive through EM (Meek et al., 2007). While the risk committee can also play an important function in stabilizing the risk appetite in financing, investing, and other vital decisions, it can also play a significant role in regulating the risk appetite. A competent risk committee can limit the potential for manipulation of risky investments with high exposure. The aforementioned committees may only have an indirect role in managing EM, but the audit committee can play a direct and crucial role. According to the findings of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (1999), the audit committee is the "ultimate watchdog" of the financial reporting system. Karamanou and Vafeas (2005) discovered that effective CG is connected with improved financial disclosure quality and honesty. The size of a committee determines its competence and capacity, as well as its supervision and reporting processes. Beasley and Salterio (2001) asserted that larger monitoring committees are superior due to their wider breadth of knowledge. A number of independent directors on these committees is better equipped to serve as active overseers of the financial reporting process and decision-making process, which has the potential to minimize EM and impact the financial reporting process (Klein, 2002). In addition, sub-level committee activities, like meetings, can be a proactive strategy to limit EM or a proactive response to reporting problems. The independence of the committee chairman can increase the likelihood that shareholder interests will be protected. Ignoring the findings of Yermack (1996), which suggest that smaller audit committees are more effective monitors, and those of Peasnell et al. (2005), which disputed the association between EM and audit committee features, we propose the following hypothesis:

*H3: Risk committees with large size, a higher proportion of independent directors, and a frequency of meetings negatively affect earning management.*

*H4: Audit committees with a large size, a higher proportion of independent directors and NEDs, and a frequency of meetings negatively affect earning management.*

*H5: Compensation committees with a large size, a higher proportion of independent directors, a frequency of meetings and the presence of an independent chairman negatively affect earning management.*

Active boards are required to safeguard the interests of shareholders and other stakeholders. Marrakchi Chtourou et al. (2001) concluded that companies whose directors dedicate more time and energy to active participation in the company's affairs are better able to prevent manipulation. Frequency of meetings, board involvement, and member attendance are essential evaluation criteria for board involvement. Conger et al. (1998) proposed that board meeting time is an essential resource for enhancing board effectiveness. Boards that meet regularly are more likely to properly address company issues (Lipton & Lorsch, 1992). The frequency of board and audit committee meetings was associated with lower levels of discretionary current accruals (Conger et al., 1998; Vafeas, 1999; Xie et al., 2002; Biswas et al., 2022). In contrast, Lorca et al. (2011) argue that meetings as routine chores consume a significant amount of time in setting the agenda and minutes, which could delay decision-making in response to market signals. It has been hypothesized, however, that there is a greater propensity of earlier studies to adhere to the potential for negative impact after the hypothesis.

*H6: Frequent board meetings and larger involvement (attendance) by members and independent directors negatively affect earnings management.*

Managers with access to asymmetric information have the discretion to share or withhold the information to advance their own objectives (Demsetz & Lehn, 1985). Scott (1997) and Schipper (1989) characterized it as an excellent setting for selective and distorted reporting of information. It is believed that moral hazard can only be addressed by more transparency and stricter rules. According to empirical evidence presented by Richardson (2006), the degree of information asymmetry (bid-ask spread and forecasts) is strongly correlated with the degree of EM. Consistent with theoretical assumptions, and empirical evidence, Zhou (2001) reveals that firms that disclose less tend to participate in more EM and vice versa. The negative relationship is reinforced by the most recent study by Uwalomwa et al. (2017), which found that disclosure quality (discretionary accruals) across Nigerian banks showed a substantial negative correlation with EM. Moreover, Ohadi and Shamsjahan (2013) found that enterprises with lesser discretionary accruals are less vulnerable to EM. Even Healy (1985) and P and Busru (2021) viewed disclosure as a factor that reduces information asymmetry. Thus, the following hypothesis has been formulated in the same context:

*H7: Environmental, social, and governance (ESG) disclosures have a negative impact on earning management measured through discretionary accruals.*

The monitoring authority gained from the ownership structure results in a form of control over the organization, especially over the top management. In addition to governance factors, ownership may be one of the most important elements for improving the quality of financial reporting, and the literature supports that different ownership structures imply different incentives to control and supervise a company's management (Shleifer & Vishny, 1997, 1986). The ownership structure is directly or indirectly responsible for sustaining degrees of information asymmetry, which

can directly or indirectly impact earnings quality and managerial accounting decisions. The findings of Debnath et al. (2021) demonstrated that enterprises with low levels of inside ownership tend to lower discretionary spending to control profitability.

Alves (2012) discovered that both ownership concentration and managerial ownership have a negative impact on EM, as more managerial stock ownership is predicted to align managerial interests with those of shareholders. After controlling for company-specific characteristics such as firm size, financial leverage, sales growth, and operating performance, Bansal (2020) discovered that family enterprises are less likely to engage in earnings management than their non-family counterparts. According to Guo et al. (2015), foreign investors play an independent role in restraining real EM relatively having few business ties to local management, improving the accounting oversight of local firms, and thus actively aiding in preventing opportunistic managerial behavior (Chung et al., 2005) and EM.

In contrast, according to the perspective of Chung et al. (2002), block holders with an absolute majority over minority shareholders and absolute control over management might manipulate accruals to obtain the desired level of earnings based on their whims. The entrenchment or expropriation consequences of managerial ownership could have a favorable impact (Cheng & Warfield, 2005). Ji et al. (2015) determined that there is no significant correlation between ownership structure and profit quality. Using the assumption that contradicting outcomes are accidental, coincidental, and unplanned in accordance with the effective monitoring hypothesis, the following hypothesis has been formulated:

*H8: The ownership structure has a significant negative impact on earnings management as assessed by discretionary accruals.*

### 3. RESEARCH METHODOLOGY

The study was conducted under a causal research design to look at how one set of variables (CG) affected another variable (EM). The deductive nature of research has led to the formulation of directional hypotheses that would be tested in the following sections. The population of the study was made up of publicly traded Indian companies. After careful elimination from NSE 500 companies, 270 remained as the sample for the study. The sample for the study initially consisted of NSE 500 companies, with 270 remaining as the final sample after methodical exclusion. Following the stepwise technique, the original sample was decreased to 334 by excluding banking and financial enterprises due to differences in asset, liability structure, and regulatory requirements (Adams & Mehran, 2003). Due to the lack of data, a further reduction in the sample size was done. The ultimate sample size was reduced to 270 due to the firm's inability to sustain its distinct existence during the study period. The study period consisted of 9 financial years, from 2007-2008 to 2015-2016, and included the years subsequent the revision of Clause 49 of the listing agreement by Securities and Exchange Board of India (SEBI, 2004) on April 8, 2008, and the issuance of new CG optional guidelines and corporate social responsibility voluntary guidelines

by Ministry of Corporate Affairs (MCA) in India. Hence the sum of firm-year observations was 2430. Data were obtained from the Bloomberg and Prowess databases, and for any omitted entries, the company's financial filings for that year were taken into consideration.

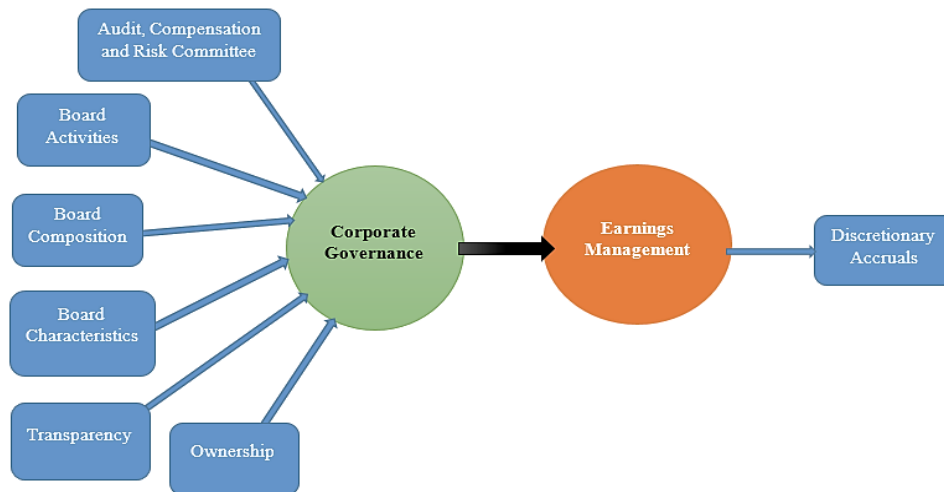
The covariance-based structural equation modeling (SEM), a widely used technique, seeks to reproduce the theoretical covariance matrix exclusive of regard to explained variance, whereas the partial least square structural equation modeling (PLS-SEM) technique seeks to capitalize on the explained variance of the dependent constructs (Hair et al., 2013). For the current study PLS-SEM technique was used for analyzing the data and results were taken into consideration for testing the framed hypothesis. Using smart PLS-SEM software, the causality among variables was analyzed to estimate explained variance and determine the significance level by bootstrapping with  $p$  and  $t$  values. Path coefficients were calculated using the partial least squares algorithm, which is described as a series of regressions in terms of weight vectors produced upon convergence to meet fixed point equations (Dijkstra & Henseler, 2011). For testing the statistical significance of various PLS-SEM outcomes, including path coefficients, outer loadings, and R-square values that are compatible with PLS bootstrapping, a non-parametric technique was followed. This is a distribution-free test that may be useful even if the data are not normally distributed, as it utilizes a non-parametric bootstrap approach (Efron & Tibshirani, 1986). This method is useful to test hypotheses and expect reliable results

and minimize measurement error, especially when there are more variables (Busru et al., 2020; Busru et al., 2022). To estimate the PLS path model, random subsamples are taken from an original set of observations with substitution. This procedure is recurring until a considerable quantity of unsystematic subsamples has been generated. The subsample parameter estimates (e.g., outer weights, outer loadings, and path coefficients) are used to create standard errors for the estimates to calculate  $t$  values and evaluate the significance of each estimate.

As opposed to reflecting indicators, which are virtually interchangeable, significant correlations across items in a measurement model employing formative constructs are not anticipated during the initial phase of formative measurement model assessment validation. The bootstrap process is then applied to evaluate the importance and relevance of formative indicators. To evaluate collinearity between constructs and indicators, variance inflation factor (VIF) values have been determined, and in every case, they are less than two. In addition, to address the significant difficulties of outer weights, the significance level has been examined and insignificant indicators have been eliminated from the model. The outcomes are shown in Table 1. Our endogenous latent variable (dependent variable) is a lone indicator construct that does not sanction measurement error to be adjusted.

The link between the formative CG components and EM, represented by a single indicator as discretionary accruals, is depicted in Figure 1 of the study model.

Figure 1. Model specification



The indicators of good governance like board/committee size, independence, number of meetings, and attendance in them were used to structure constructs used as a measure of good corporate governance. Board characteristics consist of gender, age, and experience diversity in the board. Further for ownership dynamics percentage of foreign, concentrated, and institutional ownership in the company was used as an indicator of ownership structure. Similarly, for the transparency construct environmental social and governance scores from Bloomberg were used to depict the degree of ESG friendliness and disclosures. The discretionary

accruals are computed by quantifying the non-discretionary accruals as a fraction of the total accruals in the modified Jones model which proves to be the most dominant test for detecting EM (Dechow et al., 1995; Kamran & Shah 2014; Busru et al., 2022).

#### 4. RESULTS

Indicator loadings and their significance level are shown in Table 1. The indicator loadings denote the actual contribution of indicators in explaining the construct they are linked with in the overall

model. The insignificant indicators from constructs in Table 1 have failed to add to the efficiency of that particular construct in explaining the variability of discretionary accruals. Indicators mostly board and committee independence highlights the hazard of nominal independence in Indian corporate boards.

Other insignificant grey areas of governance include board age and leadership in overall board and committees determine free reign board leadership and insignificance of expertise hypothesis in Indian corporate context.

**Table 1.** Outer weights (loadings) and significance level of indicators forming constructs

<i>Formative construct</i>	<i>Indicators</i>	<i>Outer weights (outer loading)<sup>Significance level</sup></i>
Audit committee	<i>Ac_Ind</i>	0.287 (0.330) <sup>NS</sup>
	<i>Ac_M</i>	0.523 (0.501) <sup>*</sup>
	<i>Ac_MA</i>	0.060 (0.102) <sup>NS</sup>
	<i>Ac_NED</i>	0.544 (0.731) <sup>**</sup>
	<i>Ac_S</i>	0.361 (0.665) <sup>**</sup>
Board activities	<i>BA_BM_Attendace</i>	0.412 (0.639) <sup>**</sup>
	<i>BA_BM_ID_Att</i>	0.330 (0.593) <sup>**</sup>
	<i>BA_Board Meetings</i>	0.717 (0.755) <sup>***</sup>
Board composition	<i>BC_BoardSize</i>	0.037 (0.717) <sup>***</sup>
	<i>BC_NED</i>	0.853 (0.946) <sup>***</sup>
	<i>BC_WomInBoard</i>	-0.321 (-0.493) <sup>**</sup>
Board characteristics	<i>BC_BoardInd</i>	0.065 (0.144) <sup>NS</sup>
	<i>BC_BAvAge</i>	0.423 (0.413) <sup>*</sup>
	<i>BC_CeoDuality</i>	0.347 (0.283) <sup>NS</sup>
	<i>BC_CeoTenure</i>	-0.161 (-0.111) <sup>NS</sup>
	<i>BC_AveTenureofBoard</i>	-0.201 (-0.088) <sup>NS</sup>
Compensation committee	<i>BC_BAgeRange</i>	0.834 (0.829) <sup>**</sup>
	<i>CC_CP</i>	-0.197 (-0.169) <sup>NS</sup>
	<i>CC_Meetings</i>	-0.653 (-0.497) <sup>NS</sup>
	<i>CC_Size</i>	0.898 (0.715) <sup>NS</sup>
Ownership	<i>CC_Ind</i>	-0.171 (-0.163)
	<i>OW_Concentrated</i>	0.472 (0.325) <sup>NS</sup>
	<i>OW_Frqn_Percentage</i>	0.459 (0.277) <sup>NS</sup>
	<i>OW_Insider_Percentage</i>	0.350 (0.439) <sup>NS</sup>
Risk committee	<i>OW_Inst_Percentage</i>	-0.762 (-0.743) <sup>NS</sup>
	<i>RC_Ind</i>	0.367 (0.329) <sup>NS</sup>
	<i>RC_Meetings</i>	-0.633 (-0.403) <sup>NS</sup>
Control variables	<i>RC_Size</i>	0.861 (0.725) <sup>**</sup>
	<i>Sales</i>	0.948 (0.984) <sup>***</sup>
	<i>Tca</i>	0.092 (0.111) <sup>**</sup>
Disclosures	<i>Total Assets</i>	0.117 (0.247) <sup>***</sup>
	<i>Tr_EnvDis</i>	0.511 (0.739) <sup>***</sup>
	<i>Tr_GovDis</i>	0.370 (0.592) <sup>**</sup>
Earnings management	<i>Tr_SocDis</i>	0.544 (0.741) <sup>***</sup>
	<i>Discretionary Accruals</i>	1.000

Note: NS = Not significant. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Source: SmartPLS output.

In Table 2, descriptive statistics advocates that nearly all variables are approaching normalcy. As the kurtosis and skewness statistics are closer to 0.5 (- or +), the distribution is approximately deemed to

be closer to the normal. Although normality is not a prerequisite for variance-based PLS models, still the normality supposition is held in our data set.

**Table 2.** Descriptive statistics of the variables (Part 1)

<i>Variables</i>	<i>Mean</i>	<i>Min</i>	<i>Max</i>	<i>SD</i>	<i>Kurtosis</i>	<i>Skewness</i>
<i>Ac_S</i>	3.74	2.00	6.00	0.99	-0.28	0.10
<i>Ac_Ind</i>	77.66	40.00	100.00	10.27	0.69	-0.10
<i>Ac_M</i>	4.64	2.00	8.00	1.49	-0.31	0.27
<i>Ac_MA</i>	84.08	60.00	100.00	8.15	-0.13	-0.47
<i>Ac_NED</i>	3.84	2.00	6.00	0.95	-0.54	0.06
<i>CC_Size</i>	3.25	1.00	5.00	0.91	-0.49	0.28
<i>CC_Ind</i>	69.16	50.00	90.00	9.30	-0.72	-0.04
<i>CC_Meetings</i>	2.20	0.00	5.00	1.24	-0.24	0.28
<i>CC_CP</i>	0.81	0.00	1.00	0.39	0.59	-1.61
<i>RC_Size</i>	3.29	1.00	5.00	0.78	0.39	0.53
<i>RC_Ind</i>	65.94	50.00	83.33	7.43	-0.17	-0.72
<i>RC_Meetings</i>	2.11	0.00	5.00	1.26	-0.41	0.38
<i>BC_BoardSize</i>	9.54	4.00	18.00	2.64	0.17	0.53
<i>BC_BoardInd</i>	51.81	25.00	90.00	10.43	0.44	0.21
<i>BC_NED</i>	6.94	3.00	12.00	1.94	-0.19	0.28
<i>BA_Board Meetings</i>	5.57	1.00	12.00	2.25	0.02	0.41
<i>BA_BM_Attendace</i>	83.67	46.79	100.00	9.44	0.48	-0.71
<i>BA_BM_ID_Att</i>	80.17	50.00	95.00	9.83	0.24	-0.77

**Table 2.** Descriptive statistics of the variables (Part 2)

Variables	Mean	Min	Max	SD	Kurtosis	Skewness
BC_BAvAge	59.55	40.15	70.00	5.05	-0.51	-0.07
BC_BAgeRange	25.89	-1.90	64.80	11.14	-0.04	0.42
BC_CeoDuality	0.33	0.00	1.00	0.47	-1.47	0.73
BC_WomInBoard	13.82	5.00	30.00	4.24	0.79	0.66
BC_CeoTenure	4.74	1.00	10.00	2.12	-0.53	0.24
BC_AveTenureofBoard	7.94	2.02	19.97	3.56	0.29	0.63
Tr_GovDis	45.09	28.57	58.93	4.12	2.08	0.80
Tr_EnvDis	10.98	2.14	29.85	4.14	2.27	0.68
Tr_SocDis	18.60	0.88	44.91	9.73	-0.20	0.46
OW_Inst_Percentage	34.49	-5.66	110.45	27.13	-0.63	0.65
OW_Frgn_Percentage	12.81	0.50	39.80	8.83	-0.11	0.76
OW_Insider_Percentage	13.29	0.50	39.97	8.04	0.49	0.39
OW_Concentrated	54.85	1.94	99.59	16.67	-0.33	-0.08
C_EPS	12.35	-9.68	49.90	11.03	0.56	0.91
C_SALES	40,857.13	2,074.62	149,593.38	33,783.52	0.22	0.99
C_TA	47,519.68	2,033.60	149,757.02	34,759.14	-0.14	0.68
C_Assets_(T-1)	3,310.57	-9,480.55	14,977.90	3,690.00	1.57	0.55
Discretionary_Accruals	0.05	-0.59	0.57	0.13	1.12	0.01
Cash_Eqv	2,208.44	0.20	9,924.40	2,405.22	0.39	1.20

Source: SmartPLS output.

R-square (coefficient of determination) indicates the combined weight of the exogenous latent variable on the endogenous latent variable. It signifies the variance in endogenous variables that can be explained by all the exogenous constructs associated with it. In Table 3, all CG constructs (ownership, audit committee, risk committee, compensation committee, board composition and characteristics, board activities, and transparency, including control variables) account for 34.1% of the variance in the endogenous construct (abnormal accruals used as a substitute for EM) in our path model.

**Table 3.** R-square and adjusted R-square

Relationship (CG-EM)	R-square	Adjusted R-square
EM	0.329	0.318

Source: SmartPLS output.

Path coefficients presented in Table 4 and Figure 2 are the estimated path relationships in the structural or inner model between the different constructs of the model and are like the standardized beta of regression analysis. The results denote

the probable change in endogenous construct (EM substitute used abnormal accruals) for a unit change in exogenous CG constructs explained by their indicators. The statistical results of the negative impact of CG on EM are confirmed by negative path coefficients in the model. However, risk and compensation committees and ownership have failed to significantly contribute to explaining exogenous latent construct (EM) while board composition, characteristics, activities, and transparency have a statistically significant negative impact on discretionary accrual construct. The results reveal that delegating the responsibility of overseeing the activities of management to the subcommittees has miserably failed to curb the menace of manipulating financial communication with stakeholders. Moreover, the ownership structure does not restrict the freedom of managers to manipulate financial information as its effect on discretionary accruals is insignificant. However, board composition, characteristics, activities, and ESG disclosures are important components of the CG mechanism to shrink earnings management.

**Table 4.** Inner model path coefficients and p-values/t-values

Relationship	Path coefficients	Significance level
Board composition → EM	-0.065	***
Board characteristics → EM	-0.047	***
Audit committee → EM	-0.020	NS
Risk committee → EM	-0.027	NS
Compensation committee → EM	-0.029	NS
Board activities → EM	-0.057	**
Disclosures → EM	-0.030	*
Ownership → EM	-0.015	NS
Control variables → EM	0.557	***

Note: NS = Not significant \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Source: PLS-SEM output.

Figure 2. Diagram with outer weights path coefficients of CG and EM

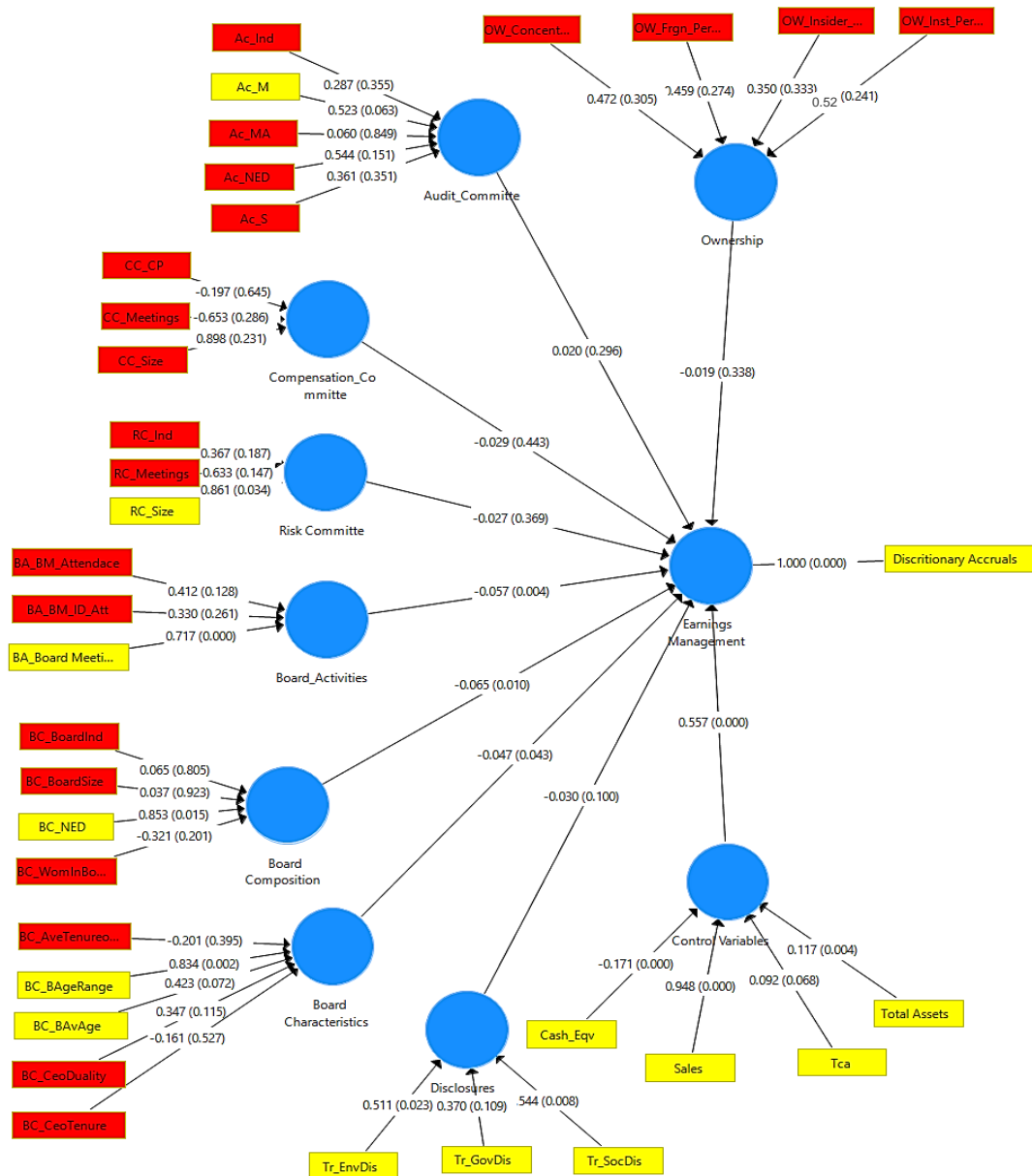


Table 5 and Figure 3 display the effect square ( $f^2$ ), which illustrates the relative effect of various exogenous variables on endogenous latent variables via changes in the R-square. It is the change in the R-square value when a specific exogenous construct is removed from the model. Cohen (1988) categorized  $f^2$  values of 0.02 to 0.15, 0.15 to 0.35, and 0.35 and above as small, medium, and strong effects, respectively, and 0.02 to 0.15 as a moderate effect, 0.02 is deemed to have no effect size. From Table 5 and Figure 3, it is obvious that, except for control variables, all other model constructs have condensed or null effect sizes, showing that excluding CG structures from the model has no or negligible influence on explaining R-square. While

eliminating model-constructed control variables will have a significant impact on explaining R-square.

Table 5. Effect size ( $f^2$ ) of CG and EM

CG constructs	EM
Audit committee	0.000
Board characteristics	0.003
Board composition	0.003
Board activities	0.003
Compensation committee	0.004
Control variables	0.453
Disclosures	0.002
Ownership	0.000
Risk committee	0.001



Figure 3. Diagram with effect size (f<sup>2</sup>) of CG and EM

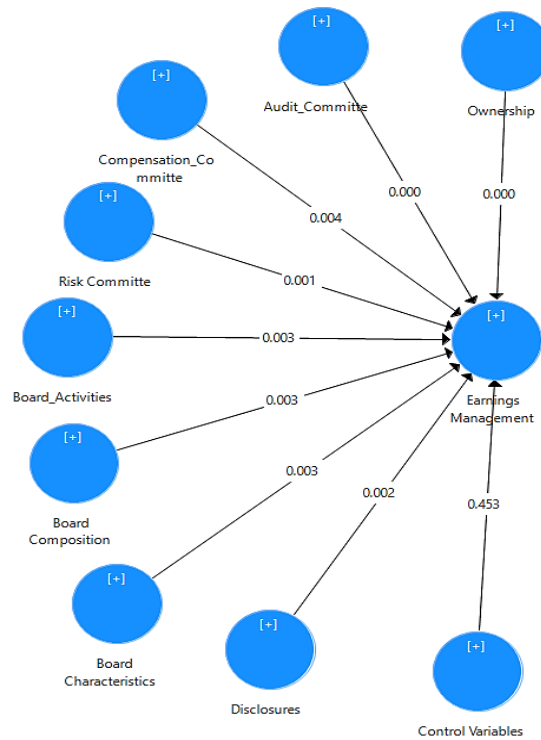


Table 6 represents the decisions of framed hypotheses based on direction (sign) and the significance of path coefficients. The results

indicate that the researchers have failed to accept the hypothesis regarding committee-level governance and ownership constructs.

Table 6. Results of the tested hypotheses of the model

Directional research hypothesis	Decision/Result
H1: The magnitude of earning management is lower in boards with a structure characterized by a large board size; more independent and non-executive directors.	Accept
H2: Experienced, diversified, and diluted CEO position boards have a significant negative impact on earnings management.	Accept
H3: Risk committees with large size, a higher proportion of independent directors, and a frequency of meetings negatively affect earning management.	Reject
H4: Audit committees with a large size, a higher proportion of independent directors and NEDs, and a frequency of meetings negatively affect earning management.	Reject
H5: Compensation committees with a large size, a higher proportion of independent directors, a frequency of meetings, and the presence of an independent chairman negatively affect earning management.	Reject
H6: Frequent board meetings and larger involvement (attendance) by members and independent directors negatively affect earnings management.	Accept
H7: Environmental, social, and governance (ESG) disclosures have a negative impact on earning management measured through discretionary accruals.	Accept
H8: The ownership structure has a significant negative impact on earnings management as assessed by discretionary accruals.	Reject

5. DISCUSSION

All CG constructs have a significant negative impact on discretionary accruals except ownership, audit, risk, and compensation committees. Environmental social and governance disclosures, board structure, characteristics, and processes have significantly contributed to enhancing earnings quality consistent with prior studies (Bala & Kumai, 2015; John & Senbet, 1998; Ittonen et al., 2013; Conger et al., 1998; Vafeas, 1999; Xie et al., 2002; Uwalomwa et al., 2017; Ohadi & Shamsjahan, 2013; Biswas et al., 2022). Monitoring through subboard committees seems an illusion and has yet to go a long way toward an effectual control mechanism. Contradictory to prior research, audit committee (Abbott et al., 2004) and ownership are insignificant in having any impact on EM (Almari et al., 2021).

The ineffectiveness of committee-level governance to reduce space for EM in the Indian corporate context may be attributable to the infancy of committee-level governance, multiple directorship positions in other companies, multiple memberships on other committees, limited information, and incompetence (Agrawal & Knoeber, 1996; Xie et al., 2002; Hermalin & Weisbach, 2003). While the inclination of committee members rooted in political, social, and cultural factors may influence decision-making (Wanyama et al., 2009), the Indian cultural setting, especially in public sector businesses, is extremely likely to have a greater impact. Westphal and Bednar (2005) identified “pluralistic ignorance” as a characteristic of board dynamics and decision-making, in which members fail to express concerns and opinions, contributing to set literature documenting the inability of the

board and committee-level composition and activities to limit EM on cost stakeholders' interest. Other possible causes could be the incompetent board, lacking requisite skills, real versus nominal independence issues, busyness due to multiple memberships, and empowered leadership of committees.

Ownership structure ineffectiveness in enhancing earnings quality result is consistent with the entrenchment hypothesis which states the ineffectiveness of insiders' ownership institutions and block holders in monitoring the managerial behavior of EM. Supported by the view of Chung et al. (2002) depicting that block holders having an absolute majority over minority shareholders and having absolute power over management can manage accruals to achieve the desired level of earnings according to their whims and fancies. While management ownership inefficiency could be a result of entrenchment or expropriation effect, these are unlikely explanations (Cheng & Warfield, 2005). Institutional investors are extremely passive investors who are more inclined to sell their stakes in underperforming companies than to devote resources to monitoring and enhancing their performances. This could be the reason for institutional ownership to be statistically insignificant to determine the distortion in financial communication. Foreign ownership also failed to affect earning quality on the grounds of remoteness and technological and constitutional differences affecting the communication process. Moreover, our results are consistent with recent findings of Ji et al. (2015) stated no significant association between ownership structure and earnings quality. This outcome is unsurprising given that the majority of the shareholding remains in India, generally with the founder or his immediate family, which frequently engages directly or indirectly in corporate management and determines the majority of management choices. Our findings have significant policy implications because they show the need to encourage institutions and individual block holders to follow CG principles to offer effective monitoring of EM in Indian enterprises.

## 6. CONCLUSION

The purpose of the study was to assess the efficiency of Indian CG in controlling earnings management practices in listed Indian companies. While hypothesizing a negative association between excellent governance and EM based on earlier research, we found a positive correlation. Using structural equation modeling with partial least squares (PLS-SEM), the effect was examined for a sample of 270 NSE listed Indian companies over

nine years spanning 2007–2008 to 2015–2016. Only in the case of effective ownership structure and committee-level governance have the results been conflicting, and it has not been possible to assert causality on earnings quality consistent with studies of Shleifer and Vishny (1997) and Biswas et al. (2022) which state that there is no available evidence of corporate governance being the for eternity best way to curb the freedom of managers. Using Cohen's (1988) findings, referred as effect size, all CG constructs contribute zero or very little to the explanation of changes in discretionary accruals. Consequently offering a significant opportunity for an effective CG system in India more focused on profit quality through a value-based pragmatic governance system, notably through subordinate or committee-level governance for improved stakeholder protection and value addition. In addition, information processing accounting competencies can be imparted to directors through various training and development programs to improve coherence in business direction and approach, ensure corporate responsibility, and excel company accountability for the confidence of stakeholders in emerging and less efficient markets such as India.

The study has highlighted the areas of governance effective in contributing to fair reporting of financial communication to stakeholders. The results contribute to determining the course of action for controlling bodies which will enhance transparency through the proactive role of CG. Highlighted ineffective areas of governance to control EM through our study will reinforce investors' and fund managers' decisions to avoid investing in the hazy entity. The study can be extended to banking and financial companies with more qualitative aspects of corporate governance like morality and competency level of directors. In addition, real earning manipulation detection tools can also be used to measure earnings quality. The support of alternative methodologies like causal research design using quantile regression analysis can be used to detect the size and magnitude of earning manipulation more effectively.

The study was conducted under a causal research design supported by prior literature within a conceptual framework. Nevertheless, the data has been collected from secondary sources thus accuracy of our results is largely dependent on the reliability of the data source, however randomly some data entries have been cross-checked with the annual reports of the companies. The study only focused on listed non-banking companies, which has limited the scope and generalization of our results to small banking firms or firms that fail to attain listing privilege hence providing scope for further extension of the research by taking these samples.

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