

The Effect of Audit Quality on Earning Management within Public Listed Companies in Sri Lanka

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Abstract

This research investigates the relationship between audit quality and earnings management in the context of publicly listed companies in Sri Lanka. Earnings management, the discretionary manipulation of financial statements, has significant implications for financial reporting integrity and market confidence. Recognizing the critical role of audit quality in ensuring the reliability of financial information, this study aims to empirically explore whether variations in audit quality influence the extent of earnings management within the Sri Lankan business landscape. Audit quality was measured in the study using three audit proxies: audit firm size, audit fees, and audit committee independence. The degree of earnings management was measured using a discretionary accruals perspective. The study's scope focuses only on external audits and their impact on earnings management. There are several types of audits, but this study area is limited to external audits due to the availability and more reliable access to information. This research is mainly focused on secondary data gathered from publicly listed companies in Sri Lanka. 40 companies were selected for the study based on 296 publicly listed companies in Sri Lanka, using their most recent five-year annual reports from 2018 to 2022. The study data were analyzed using regression analysis, correlation analysis, and descriptive statistical measures. As an outcome, this study's conclusions will provide more insight into how audit quality affects earnings management. According to the study, there is a small association between audit quality and the degree of earnings management in Sri Lankan listed firms. According to the study, there is a negative correlation between audit quality and the level of earnings management in Sri Lankan listed companies. Additionally, the study shows that the oversight mechanism is ineffective because there is no statistically significant correlation between earnings management and the variables. As a result, the study concludes that the level of earnings management is not significantly impacted by audit quality. This may be because there are many inefficient monitoring systems in place, which discourage auditors from improving auditing.

Keywords: Audit Quality, Earnings Management, Discretionary Accruals, Audit Firm Size, Audit Fee, Audit Committee Independence.