Relationship of Corporate Governance and Earning Quality – Special Study in India

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ABSTRACT:

Corporate governance has become a key factor determining a company's transparency, accountability and financial reporting quality. As corporate restructuring, investor activism and financial sector reforms are becoming increasingly apparent in emerging economies like India after the country's liberalization, the influence of corporate governance on earning quality of listed companies has become an area of interest for researchers and practitioners alike. This study attempts to correlate the governance quality of a company and its earnings quality using a comprehensive governance score and established earnings quality score.

This study includes an analysis of 389 listed, non-financial companies from BSE 500 Index for financial year 2023–24. However, all banking and financial service companies are excluded as conventional measures of earnings quality will not apply to highly regulated financial institutions. A composite score of corporate governance of sample firms was created by using seven indicators like 1. Size of the board; 2. Independence of Board; 3. Proportion of female directors on board; 4. Board Meeting frequency; 5. Independence of audit committee; 6 CEO - Chairman Duality; and 7. Quality of audit reports.

In terms of earnings quality, the study uses Beneish M-Score, a widely used indicator that computes a score that identifies probability of earnings manipulation. The empirical results from an ordinal regression model estimated using the sample data indicate that the corporate governance has a statistically significant impact on the earning quality of a firm.

To test the above stated hypothesis an ordinal regression has been used. Control variables like Size of firm, ROA, EPS, PAT, Institutional holdings and Industry of firm has been used in the study to make it more robust. All statistical computation has been done by IBM SPSS software.

The findings of this study highlighted positive association between Corporate Governance practices followed by firm and

its earnings quality. In short higher quality of corporate governance practices results into better earnings quality by reducing possibility of earnings manipulation and ensuring reliability of reported earnings.

The findings of this study must be useful to a number of different stakeholders including investors, managers, regulators and, most importantly, researchers who want to continue further research on this area.

This study has limitation of having data for single year i.e. FY2023-24 for sample of listed Indian companies only. Thus, future studies can rely on larger time series and even cross-country study..

Keywords: Corporate Governance; Earnings Quality; Beneish M-Score; Earnings Manipulation; Board Independence; Indian Listed Firms; Financial Reporting Quality; Corporate Transparency.

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1. Introduction

Financial and management researchers over the decades have produced a lot of research papers on corporate governance. Most of world's large corporations today are separate from their owners and so the system of corporate governance has become a highly significant subject. Several large corporate failures observed world-wide due to manipulation of financial data by top management, for example, Enron, WorldCom, Parmalat and Satyam Computer Services etc.

Definition Corporate governance refers to the set of rules, practices, policies and structures by means of which a company is governed and monitored by its Board of Directors so as to add value to shareholders, represent their interests, and protect their investments. The primary objectives of an adequate system of corporate governance are to safeguard transparency, accountability, fairness and the interests of all stakeholders.

Jensen and Meckling (1976) describe the mechanisms of corporate governance as means to avoid agency conflicts of managers with shareholders. According to agency theory such conflicts are monitored adequately, managers may engage in opportunistic behaviour to maximize personal wealth and thus exploiting the corporation's assets.

1.1 Background of the Study

Frauds such as Enron scandal (2001), WorldCom scandal (2002), Satyam Computer scandal (2009) and IL&FS scandal (2018) etc. exposed major governance failures and lack of adequate check on accounting practices leading to serious doubts on accounting earnings and protection to investors' (Monks & Minow, 2011).

Government of emerging economies like India have focused after liberalization of economy to enhance corporate governance practices. In order to improve the corporate governance practices, various reforms have been introduced in the corporate governance regime of India from time to time by various regulatory bodies like "Securities and Exchange Board of India (SEBI)", "Stock Exchanges" and other governing bodies of India. These reforms in corporate governance regime of India were introduced through introduction of "Clause 49 of the Listing Agreement" of "Stock Exchanges and The Companies Act, 2013" of Government of India (Mohan & Chandramohan, 2018). These reforms have focused on improving the functioning of Board of companies, enhancing disclosure, improving the independence of audit and other functions so as to make the companies accountable.

Several studies have been conducted by the researchers in the area of finance and accounting

to study the earnings quality of firms. Earnings quality can be characterized by the extent and timing by which the reported earnings of firms reflect their true economic performance and cash flows generated in the future. High quality earnings are sustainable, accurate, complete, transparent and unbiased. They do not contain any element of aggressive accounting like smoothing, management manipulation, window dressing and even fraud.

There are several reasons as to why managers would wish to manipulate the earnings of a firm. The main reason would be to report earnings which are consistent with market expectations. By reporting higher than expected earnings, for example, the stock price of a firm will increase. As managers of a firm are often granted stock options, an increase in stock price will result in higher levels of additional compensation for the manager. The other reason for manipulating earnings is that managers can report higher levels of earnings to hide the true underperformance of a firm. Financial reports are generated by the management of a firm and investors use these reports to make investment decisions. Thus, by manipulating earnings, not only will investors be making suboptimal investment decisions, but capital will also be inefficiently allocated. Therefore, strong corporate governance structures are expected to mitigate such earnings manipulation.

A considerable amount of research has already been carried out in developed economies in order to analyse the association between corporate governance and the earning quality. However, similar studies have not been conducted in the emerging economies such as India. Moreover, even in India, the majority of the research work carried out so far has been confined to the analysis of connection between the corporate governance and the firm performance and not with the earnings quality.

This study shall attempt to fill the gaps in existing research and attempt to establish a link of earnings quality with corporate governance for a sample of Indian listed companies.

1.2 Problem Statement

Despite the numerous reforms and regulations and mandatory practices of corporate governance, there is no positive impact on improving quality of financial report and preventing earning manipulation. A large number of Indian companies have been recently caught in various accounting scams, non-disclosures and serious corporate governance failures. This raises a critical question whether current system of corporate governance can improve the quality of earnings.

While prior studies have investigated the individual effect of one single corporate governance mechanism like the board's independence, the audit committee, or the board's size, there is a huge research gap regarding the entire corporate governance structure and its effect on the earnings quality in India. This paper therefore examines if effective corporate governance structures prevent earnings manipulation and improve the financial reporting quality.

2. Literature Review And Hypothesis Development

2.1 Theoretical Foundations

Agency theory is most relevant theoretical framework to study the role of corporate governance on high quality earnings (HEQ). Due to the separation of ownership and control top managers have more information than other stakeholders within the firm (Jensen and Meckling ,1976). Using accounting reporting as a medium they can exercise discretion in order to protect their cash flows, to honour debt covenants, to meet analysts' expectations, or to hide a decreasing performance. Governance mechanisms increase the intensity of monitoring and the accountability of managers to all the stakeholders of the firm (Shleifer & Vishny, 1997).

Stakeholder theory further extends the agency theory by noting that a firm's corporate governance structures are set up to protect different stakeholders including, employees, debt holders, suppliers, tax authorities and minority

and outside shareholders (Freeman, 1984; Donaldson & Preston, 1995).

A Board of a company is also important for a company to derive value from resources such as expertise, external network, information, legitimacy and strategic guidance. A manager is a steward of the resources of shareholders. Therefore, Stewardship theory supports strong governance and accountability structures for enhancing transparency and building trust in the decisions and actions of the manager (Davis, Schoorman & Donaldson, 1997).

2.2 Corporate Governance in the Indian Context

The Indian corporate governance framework has gone through many transformations, primarily due to the reports of the two high powered committees namely the "Kumar Mangalam Birla Committee (1999)" on further listing of Companies and the "Narayana Murthy Committee (2003)" to examine the functioning of the audit committees in Indian corporates. Post the reports of these two committees, the biggest transformation came with the enactment of the "Companies Act, 2013" which has reinforced the corporate governance structure with many novel provisions such as mandatory composition of Board with women director, independent directors, audit committees etc. Similarly, "SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015" has also initiated many disclosure requirements for a listed company such as Board evaluation, Related Party Transactions etc. A lot of transformation has taken place in framework of corporate governance in India but a lot yet to achieve (DeFond & Zhang, 2014). In many cases, the governance parameters are treated as mere disclosure requirements and are not taken care of on a day-to-day basis by companies. There is a lot of variances in the implementation of the various governance parameters by the companies (Sarkar & Sarkar, 2008).

There are vast variations across countries and within countries in how various formal and informal structures of corporate governance affect a company. Thus, while some treat it as a mere formality to be completed, others would incorporate it into their strategic risk management and investor relations. There are many issues that require to be studied in the Indian context, for instance, how family ownership, promoter dominated firms and business groups affect corporate governance and whether independent directors can monitor and control top management effectively (Balasubramanian, Black & Khanna, 2010).

2.3 Earnings Quality and Measurement Approaches

Earnings quality is a multi-faceted attribute. For instance, Dechow and Dichev (2002) describe earnings quality in terms of the extent to which accruals reflect cash flows whereas Francis et al. (2005) have categorized earnings quality into several dimensions such as 1. persistence, 2. predictability, 3. smoothness, 4. accruals quality, 5. value relevance, 6. timeliness and 7. conservatism. Dechow, Ge and Schrand (2010) assert that in spite of the several measures and attributes of earnings quality, no single measure or attribute will be sufficient to capture all the dimensions of earnings quality. Thus, the researcher has to select a most appropriate measure depending on the research question under investigation.

The "Beneish M-Score" model is used in this study to identify the possibility of earning manipulation by a set of financial statement data. Beneish (1999) created the model that uses 8 different ratios of a company. The M-Score is then calculated by combining these 8 different scores. The study uses the high "M-Score" values to proxy for earning quality. The "M-Score" model is developed to detect earnings manipulation by a company. Beneish (1999) explained that 8 different ratios were used in "M-Score model" , such as, the growth in receivables, decline in gross margins, decline in asset quality, etc. Thus, a high M-Score value indicates that a company may be a manipulator.

2.4 Board Characteristics and Earnings Quality

Independence of Board of Directors is one of the most widely studied governance feature among others and it is aimed at protecting the interests of minority shareholders and to safeguard the accurate reporting of earnings by challenging the management. A number of prior studies have found positive relationship between features of Board of Directors and Audit Committee and lower abnormal accruals (Xie, Davidson and DaDalt, 2003 & Dimitropoulos and Asteriou, 2010).

A bigger board has more expertise and can be more effective in monitoring (Pfeffer & Salancik, 1978). However, the board can also suffer from coordination problems, free riding, and slow decision-making (Jensen, 1993). Thus, whether more directors on the board bring any value to the firm depends on several factors, most importantly whether their input adds value or dilutes the accountability of management and the board as a whole to shareholders (Sundgren & Wells, 1998).

2.5 Audit Committee, Audit Quality and Reporting Integrity

An Audit Committee is a group of individuals including inside and outside directors. It is a body of individuals who oversee the accounting activities of a firm. It reviews various aspects of accounting of a firm. An Audit Committee checks the accounting policies of a firm adopts. It also checks whether a firm has adequate internal controls in place. It checks the relationship between management and external auditors of a firm. An Audit Committee reviews financial reports prepared by the management of a firm (Reed et. al., 2002). Studies have established that existence of independent Audit Committee reduces the earnings management of a firm. Disclosure by Audit Committee regarding its oversight and the monitoring role it plays, enhances the financial reporting credibility of a firm (Xie et. al., 2003). As per the provisions of Indian laws, an independent review of the financial information prepared by the management of a firm is required to be carried out by the Audit Committee of a firm. The internal controls of a firm are also to be monitored by the Audit Committee of a firm.

A key component to test the quality of external audit function is the audit report quality. While a clean audit report does not confirm whether high quality earnings have been generated, an audit report with qualifications, emphasis of matter paragraphs and adverse comments on internal controls and other aspects to consider indicates reporting risk, accounting uncertainty and control weakness (Francis, 2011). Therefore, the quality of external audit function has been also incorporated in the composite score developed for the study.

2.6 Gender Diversity, Institutional Ownership and Monitoring

A large number of studies have established positive relationship between Gender Diversity on boards and various governance and financial measures such as value of firm (Naeem et al., 2022). The provision of minimum number of women required to be part of Board of Directors in listed and unlisted companies in India, as laid down in Section 197 of the Companies Act, 2013, has put the Gender Diversity on the corporate governance map in India. It is also thus relevant to include female board ratio as a governance measure in this study.

Institutional ownership is another variable, which has been used by several researchers as a means of external monitoring. Institutional shareholders possess the resources, and also the incentives, to ensure that the companies for which they invest provide accurate financial information so that they can make quality investment decisions (Shleifer & Vishny, 1986). Studies have established the effect of ownership structure on reporting credibility in cases of East Asian firms (Fan & Wong, 2002). For this reason, institutional ownership has also been used in the broader governance literature to study the extent to which it can constrain managerial opportunism. Higher institutional ownership generally associated with better control on financial reporting, improved monitoring which

improve investor's confidence (Velury & Jenkins, 2006)

2.7 Research Gap and Hypothesis

Prior studies proved that governance mechanisms are expected to improve earnings quality, but several gaps remain. First, although there is a large body of evidence that relate to the issue of the effect of governance and performance of firms, very little research has been conducted to establish a connection between governance and the issue of earnings manipulation for Indian firms.

Second, many studies use single governance variables to study their relation with earnings quality while overlooking the fact that all of governance is a system and thus should be studied as a whole.

Third, the Beneish M-Score remains underutilized in Indian governance studies despite its relevance for detecting manipulation risk.

Fourth, recent empirical studies, especially those using post-reform data (post 2013 onwards) relating to Indian environment would be highly relevant. Requirements for good governance as well as their effective implementation have gone through a sea change since 2013.

Accordingly, this study tests the following hypothesis:

The quality of corporate governance of listed Indian firms has a significant positive effect on their earning quality (H1).

3. Research Methodology

3.1 Research Design

This research work is based on quantitative approach. The research study aims at testing the connections of earnings quality with corporate Governance of Indian listed firms with the help of secondary data, retrieved from various public sources, including annual reports of companies, websites of stock exchanges, corporate governance reports, etc. as well as databases containing various information about the companies.

3.2 Sample Selection

The sample collected from 500 companies which are listed in BSE 500 Index. Financial institutions have not been included in study as their accounting structure and regulatory environment is different from the non-financial entities. The initial sample of 500 companies comprised of 93 financial sector companies i.e. banks and insurance companies. 13 other companies were also treated as outliers as their accounting structures and corresponding regulatory framework is significantly different from other non-financial companies and do not fit into conventional models of estimating earnings quality like Beneish's M-Score used in the present study. In summary, a study in the form of secondary data has been conducted for the year 2023–24 and consists of 389 Indian listed companies which are not financial institution.

Table 1. Sample Selection Procedure

Particulars	Number of firms
BSE 500 listed companies	500
Less: banking and financial institutions	93
Less: incomplete data and extreme observations (Outliers)	18
Final sample	389

Financial sector, including banks and insurance companies have been kept outside the study as they are regulated to follow different financial reporting format.

3.3 Sources of Data

Secondary data were collected from multiple sources, including:

- Prowess Database
- Published Annual Reports
- Stock Exchange Filings
- Corporate Governance Reports
- Financial Statements

3.4 Measurement of Earnings Quality

We used the "Beneish M-Score Model (1999)" to calculate the earnings manipulation of the companies in our sample of Indian firms.

The Beneish M-Score for estimating earnings manipulation is calculated by the following formula:

M=-4.84+.92*DSRI+.528*GMI+.404*AQI+.892*SGI+.115*DEPI-.172*SGAI+4.679*TATA-0.327*LVGI

Here,

DSRI: Days sales in receivable index (Net Receivables / Sales)

GMI = Gross Margin Index (Gross Profit/ Sales)

AQI = Assets Quality Index = Non-Current Assets / Total Assets.

SGI = Sales Growth Index (Salest / Sales t-1)

TATA = Total Accruals to Total Assets [(ΔNet Operating Assets-ΔCash)/Total Assets]

LVGI = Leverage Index [(Debt t / Total Assets t) / (Debt t-1 / Total Assets t-1)].

DEPI = Depreciation Index ((Depreciation / Total Assets) t-1)SGAI = Sales, General & Administrative Expenses Index (SGA Expenses / Total Assets).

M-Score: The M-Score is also use to find earnings manipulation. The higher the M-Score value, the higher the level of manipulation and vice-versa.

Table 2. Interpretation of M-Score

M-Score Range	Interpretation
Less than -2.22	Unlikely Manipulator
Between -2.22 and -1.78	Possible Manipulator
Greater than -1.78	Likely Manipulator

M-Scores are categorised based on criteria. Here we have assigned:

"2" for Unlikely Manipulator or No Manipulation (M-Score less than -2.22)

"1" for Possible Manipulator (M-Score between -2.22 and -1.78) and

"0" for Manipulator (M-Score greater than -1.78)

3.5 Construction of Corporate Governance Composite Score

The Corporate Governance Composite Score (CGCS) is a simple average of all relevant indicators in this study. The seven indicators are equally weighted to arrive at CGCS.

Following 7 Components Used to Calculate the CG Composite Score of a Firm.

1. BSS = Board Size Score
(Board Size / Median of Board Size).
2. BIS = Board Independence Score
(Number of Independent Directors / Board Size).
3. FRB = Female Ratio in Board
(Number of Female Directors on Board / Board Size).
4. BMS = Board Meeting Score
(Board meeting frequency/Median value of Board meetings frequency)

5. ACIS = Audit Committee Independence Score
(Number of Independent Directors in Audit Committee / Size of Audit Committee).
6. CCD = CEO – Chairman Duality
(Yes – 0 & No- 1)
7. QARS = Quality of Audit Report Score
[1- (No. of Qualification noted/ Maximum no. of Qualification noted)]

Corporate Governance Score calculated using the below mentioned composite formula:

CGCS = (BSS+BIS+FRB+BMS+ACIS+CCD+QARS) / 7

The companies within the sample have been ranked by their CG Composite Scores.

3.6 Other Control Variables

To control for the variables that might affect a specific company, six control variables have been used in this study. These variables are: 1. Firm Size (FS), 2. Return on Assets (ROA), 3. Earnings per Share (EPS), 4. Profit After Tax (PAT), 5. Institutional Holdings (IH) and 6. Industry Type (IT). These variables have been widely used in prior studies related to corporate governance and earnings quality.

Table 3. Operational Definition of Variables

Variable	Measurement	Expected implication
Earnings quality category	Beneish M-Score classification	Lower manipulation risk indicates higher earnings quality
CG composite score	Average of seven governance dimensions	Higher score indicates stronger governance
Board independence	Number of Independent board of directors divided by Total board size	Greater monitoring objectivity
Female board ratio	Female directors divided by board size	Broader board diversity and oversight
Audit committee independence	Independent audit committee members divided by audit committee size	Stronger reporting oversight
CEO-chairman duality	No duality = 1, duality = 0	Role separation strengthens accountability
Audit report quality	Inverse score based on qualifications	Fewer qualifications indicate stronger assurance
Institutional holdings	Percentage ownership by institutions	External monitoring effect

3.7 Regression Model

Since the dependent variable consists of ordered categories, an ordinal regression analysis was performed using IBM SPSS to check the relationship of independent variable (CGCS) and other control variables (FS, ROA, EPS, PAT, IH & IT) on dependent variable (EQ).

Model Specification:

EQ= α+β1*CGCS+β2*FS+β3*ROA+β4*EPS+β5*PAT+β6*IH+ϵ

Where:

EQ = Earnings Quality Category

CGCS = Corporate Governance Composite Score (Rank)

FS = Firm Size

ROA = Return on Investments

EPS = Earnings Per Share

PAT = Profit after Tax

IH = Institutional Holdings

3.7 Statistical Tools Used

The study uses:

- Descriptive Statistics
- PP Plot for Normality
- Ordinal Regression Analysis using SPSS Software.

4. Analysis And Findings

4.1 Descriptive Statistics

Descriptive statistics provide preliminary insight of the characteristic and distribution of variables used in the study which is summarized in Table 1 for 389 sample companies of listed Indian companies.

Table 4: Descriptive Statistics of Study Variables

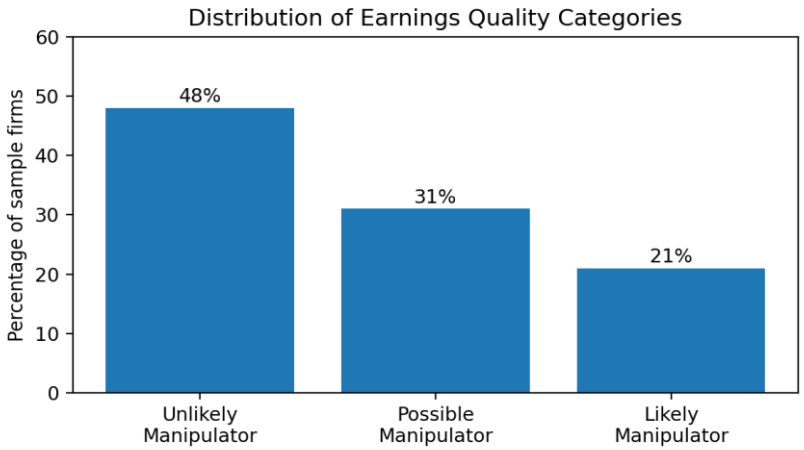
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Category of M-Score	389	1	3	2.70	.582
Rank of CG Score	389	1	407	204.09	117.897
Firm Size (Normalised value)	389	.018756443579654	139.347292607489800	3.5024412280397 55	10.162797142563040
Industry Type	389	1	11	5.66	2.867
ROA	389	-.945929196091783	.655737316293212	.097501781662337	.097342270917058
PAT (Normalized Value)	389	-3.892845360824742	89.812371134020620	4.1492374314260 73	10.918034034272713
EPS (Normalized Value)	389	-1.602957283680175	263.541073384446860	3.1899089698358 77	14.113764568453090
Institutional Holdings	389	.0300	88.9659	28.517422	16.0174749
Valid N (listwise)	389				

The average earnings quality category (M-Score) for the 389 sample firms has been 2.70. Therefore, there are a significant number of firms classified as 'Unlikely Manipulator' with even lower/Moderate earnings quality category. The mean score of corporate governance of the sample of firms was 204.09 with a standard deviation of 117.897. The variance in the corporate governance practices of the firms in the sample is huge and clearly indicates that while

there are firms that are adopting best practices in corporate governance, there are others that have yet to move even a step in this direction.

Figure 1: Distribution of Earnings Quality Categories



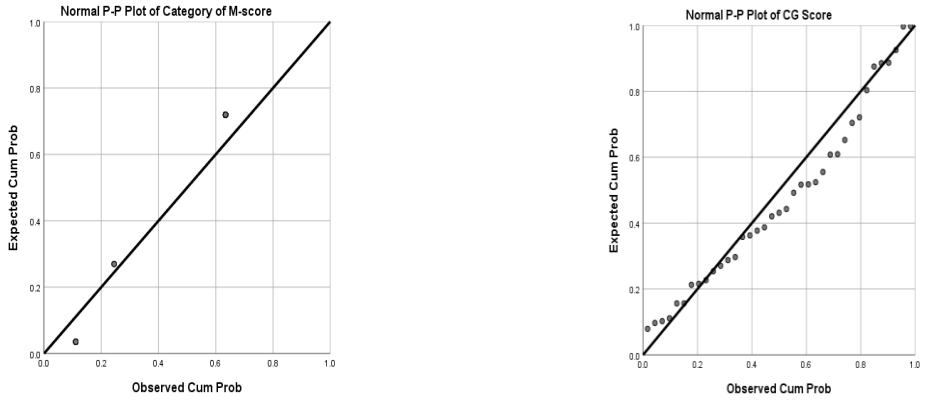
As noted in the above discussion that nearly half (48%) of the sample consists of Unlikely Manipulators; however, large proportion (31%) of other sampled firms are classified as Possible or Likely Manipulators. This is where the current study deviates from prior research and focuses specifically on the role that firm level governance can play in determining the earnings quality of a sample of firms listed on the Indian stock exchange.

4.2 Assessment of Data Normality

Before we could use the data for the regression analyses, we first tested the data for normality by means of P–P plots. The P–P plots of all the variables indicated that the data points tracked the line for expected normal distribution very well. No very extreme values were found that could have caused severe skewness in the data.

The results from the normality test indicate that our data is amenable for multivariate statistical analysis. In addition, the results indicate absence of extreme values or outliers in the data, which are commonly known to cause severe problems in terms of distribution. Hence, the regression estimates obtained in the subsequent analysis are expected to be reliable, and inferences drawn from such analysis are expected to hold good.

Figure 2: Conceptual Representation of P–P Plot



All the observations lie very close to the diagonal line.

4.3 Ordinal Regression Results

The results of the ordinal regression model on earnings quality of firms are presented in the subsequent section. These results are a function of a firm's corporate governance score and a number of control variables.

Table 5: Model Fitting Information

Model	-2 Log Likelihood	Chi-square	df	Sig.
Intercept only	530.219			
Final model	142.889	387.320	322	0.007

The model fitting information demonstrates that the final model significantly improves prediction accuracy compared with the intercept-only model. The chi-square statistic of 387.320 with a significance level of 0.007 indicates that the explanatory variables collectively contribute to predicting earnings quality.

The null hypothesis H0 is rejected by the model at $p<0.05$. The results indicate that corporate governance along with other control variables are significant in determining the earnings quality of Indian listed companies. This indicates that good governance increases financial reporting quality and results in more accurate and honest reporting.

4.4 Goodness-of-Fit Analysis

The ordinal regression model is checked for its goodness-of-fit by using the Pearson test and the Deviance test.

Table 6: Goodness-of-Fit Statistics

Test	Chi-square	df	Sig.
Pearson	351.816	454	1.000
Deviance	142.899	454	1.000

Goodness-of-fit measures for ordinal regression models measure how well the predicted category frequencies for the observed data (as produced by the model) compare with expected frequencies for the same data (i.e. observed data as opposed to predicted data for that data). From the provided table it is clear that all values indicate an acceptable fit. There are no significant discrepancies between the provided data and the expected data under the provided ordinal regression model. The model thus appears to be appropriate and reliable.

4.5 Explanatory Power of the Model

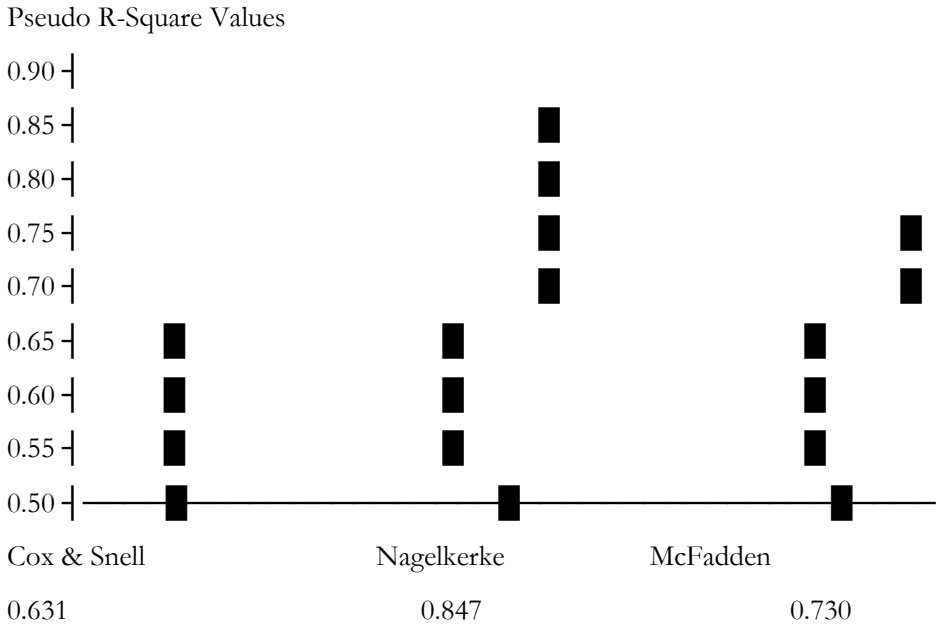
Pseudo R-square statistics for the ordinal regression models have been calculated in order to measure their explanatory power.

Table 7: Pseudo R-Square Measures

Measure	Value
Cox and Snell	0.631
Nagelkerke	0.847
McFadden	0.730

The results in terms of explanatory power of the regression model are extremely encouraging. Nagelkerke R-square of 0.847 indicates that more than 80% of the variation in the measure of earnings quality is explained by the set of independent variables. The results in terms of explanatory power are further reinforced by the McFadden R-square of 0.730. It is observed that McFadden R-square of 0.730 is in excess of the benchmark score of 0.6 or more, which is considered to be excellent. Thus, it can be safely inferred that governance mechanisms and other firm specific characteristics play a significant and crucial role in determining the earnings quality within the Indian corporate sector.

Figure 3: Comparative Explanatory Power



The High values of the pseudo-R squares measures in the Table 7 indicate that there are few variables of firm-specific characteristics and several governance mechanisms, which jointly play a significant role in determining the earnings quality of firms listed on stock exchanges in India.

4.6 Interpretation of Results

This study explores the relationship between corporate governance and the earnings quality of Indian listed companies. The findings from the study reinforce the significance of a company's governance structures, in its propensity to manipulate earnings and more importantly in reporting better and more accurate financial performance. Effective corporate governance therefore is crucial for promoting transparency, disclosure and better earnings quality.

The findings of this study are consistent with Leuz et al. (2003), Bushman and Smith (2003), and Gaio and Raposo (2014) studies, who identified the role of corporate governance in earnings quality. This study supports the view that corporate governance plays a significant role in monitoring and controlling the firm and thereby reduce agency problems, information asymmetry and improves the quality of earnings reported by firms. In essence, it enhances the credibility of reported financial information and therefore promotes financial reporting integrity.

The study has implications for all the stakeholders in a corporation and for the investors in particular. The results have implications for the corporate governance design. The fact that the best practice corporate governance mechanisms increase market credibility, reduce agency costs, increase investors' confidence and aid external finance

raised by a corporation, should be brought to the notice of all the corporate managers.

In summary, we support the alternative hypothesis and further argue that good governance mechanisms play crucial role in promoting good quality of financial reporting and sound capital market in India.

5. Conclusion

In the present study an attempt has been made to identify relationship between corporate governance and earning quality of Indian listed companies. In order to analyse governance, a comprehensive Corporate Governance Index (CGI) has been used. Earnings quality has been determined through "Beneish M-Score", a well-established proxy for earnings manipulation. Findings of this study indicate that stronger corporate governance is positively associated with better earnings quality and lower likelihood of earnings manipulation. The findings further revealed that earnings manipulation which indicate that higher governance quality would result into financial reporting credibility.

The study also finds significant positive relationship between the earnings quality and several corporate governance attributes, namely, board independence, audit committee effectiveness, and gender diversity on the boards of listed companies. Strong governance structure therefore can monitor and control the managers to reduce agency conflicts and bring integrity in financial reporting of a company.

This paper has a number of key strengths. The use of a single CGI rather than individual CG mechanisms in isolation is a major strength of the paper. The findings are thus able to provide a unique insight in to the relationship between governance quality and earnings quality in the Indian context. This extends existing research in to the determinants of reporting quality.

The study has implications for all the stakeholders including Regulators, Policy Makers, Investors, Users of Financial Reports and Corporate Managers. The study highlights the need to strengthen the provisions of corporate governance in the "Companies Act, 2013" and the Regulations in SEBI. The study also highlights the importance of effective Boards of Companies, Transparency in functioning of the Boards and Quality of Disclosure in Financial Reports of the Companies. The study also establishes the importance of Independent Oversight Mechanism in the Companies. For the Investors and other Users of Financial Reports, the study highlights the importance of Governance Quality as an indicator of Earnings Quality and Transparency of Financial Reports of the Companies.

There are limitations in the current study. Data used for the study is of single year and of cross-sectional nature and collected from listed companies in India. The study could be extended by using panel data and employing time series approach to study the dynamics between governance quality and earnings quality over time. The relationship between various governance dimensions and ESG characteristics of firm could also be studied. The study could also be extended to cross-country context to generalize the findings.

Therefore, high quality of corporate governance has a significant role to play in ensuring transparency and full disclosure and also in holding mangers and others in charge of the corporation accountable to the shareholders and other stakeholders of the company.

Reference

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