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The Impact of Audit Committee Effectiveness and Audit Quality on Financial Reporting Quality: The Case of Sri Lankan Banking Sector

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Despite the high contribution of the banking sector to the GDP in Sri Lanka and the importance of the role of audit committees in financial reporting quality maintenance, there is a dearth of research that emphasize on the impact of audit committee effectiveness and audit quality on financial reporting quality in the Sri Lankan context. To fill this lacuna, the study aims to identify the impact of audit committee effectiveness and audit quality on financial reporting quality in the banking sector in Sri Lanka during 2014 – 2018. The objectives were to identify whether there is any impact from these two factors and the kind of impact they have. Secondary data available on the Colombo Stock Exchange website of 30 Licensed Commercial Banks and Licensed Specialized banks were analyzed. The findings indicate that audit committee effectiveness (measured through audit committee size, audit committee meetings frequency and audit committee financial and accounting expertise) has an insignificant relationship on financial reporting quality. Under audit quality (measured through audit fees and audit firm size), audit fees do not show any significant relationship whereas audit firm size has a negative significant relationship on financial reporting quality. For the used control variables of this study, the leverage shows an insignificant relationship whereas the firm size has a positive significant relationship on financial reporting quality in the banking sector in Sri Lanka. This study contributes to practice by providing necessary and vital information to the regulatory institutions of the banking sector in Sri Lanka to make decisions to enhance the financial reporting quality and to enhance the disclosure requirements in the annual reports. It contributes to the extant literature by adding new knowledge through the examination and analysis of audit committee effectiveness and audit quality on financial reporting quality in the banking sector in Sri Lanka.

JEL Codes: C30, M40, M41 and M42

1. Introduction

It is vital to hold long term sustainability in banks since the performance of each bank affects the economy (Adnan, Htay, & Rashid, 2011). The Sri Lankan banking sector comprises of two classifications as Licensed Commercial Banks (LCBs) and Licensed Specialized Banks (LSBs). Together, these two classes represent the most noteworthy portion of resources in the entire financial system and play an important role in the Sri Lankan financial system by provisioning liquidity to the entire economy. It is not only applicable to Sri Lanka; it is a world scenario. The economic downturn in 2007-2008 was a result of the insolvency of world-famous banks such as Lehman

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Brothers, Royal Bank of Scotland, and Wall Street. Such incidents escalated the responsibility of the audit committee in overseeing the reporting quality (Sorensen & Miller, 2017; Yasin & Nelson, 2012) and researchers started to explore the role of audit function in enhancing financial reporting quality especially in the banking sector (Edirisinghe, 2015; Kallamu & Saat, 2015) to propose ways for ensuring reporting quality.

Financial reporting process intend to offer applicable financial data for the stakeholders of an organization and financial reporting quality help the stakeholders to take right choices (Al-Dhamari & Ismail, 2014). In the arrangement of financial statements, managers can select strategies to increase the profit of the entity (Algharaballi, 2013) i.e., earnings management where managers use their own decisions to alter financial reports with the intention of making a wrong impression about the status of the organization. Due to earnings management, the financial reporting quality will turn out to be low (Healey & Wahlan, 1999) and an independent group such as the audit committee can reduce instances of earnings management.

An effective audit committee has the duty to supervise the financial reporting process and auditor's function for a superior audit quality. This role is more significant in the banking sector compared to other business sectors, particularly in a developing economy because the banking sector has a pivotal obligation to play in any economy (Adnan, Htay, & Rashid, 2011). This significance escalates with the cross-sectional relationship the banking sector has with different industries; a bankruptcy of one bank can impact on many other industries and there may even prompt a financial disaster or a crisis in the economy (Adnan, Htay, & Rashid 2011). For instance, in Sri Lankan history, Pramukha Bank's bankruptcy in 2002 had a major impact on the Sri Lankan economy and it drastically dropped the investments in ventures as the investors were hesitant to invest with the loss of certainty and trustworthiness about future speculations and having dividends and profits (Edirisinghe, 2015).

In the Sri Lankan context, researchers who focused to assess the impact of either audit committee effectiveness or audit quality on financial reporting quality of listed sectors in the Colombo Stock Exchange (CSE) have excluded the banking sector (Ajward & Rajeewan, 2019; Velnampy, Sivathaasan, Tharanika & Sinthuja, 2014). The main reason for the exclusion of the banking sector from the sample is due to stringent rules and regulations they follow, and the diverse methods used for the accounting treatment of their financial statements (Ajward & Rajeewan, 2019). Similarly, in Sri Lankan context, most of the investigations have been conducted to evaluate the effect of audit committee effectiveness and audit quality on the financial performance by using other listed sectors in Colombo Stock Exchange excluding the banking sector (Balagobei & Velnampy, 2018; Velnampy, et al., 2014). Hence, to the best of the researchers' knowledge (and with the literature review conducted by the researchers) there is a dearth of research in examining the impact of audit committee effectiveness and audit quality on the financial reporting quality of the banking sector in Sri Lanka. In addition to this, the contribution of the banking sector to the GDP reports a high rate in Sri Lanka (KPMG, 2020) and it also highlights the importance of identifying the impact of audit committee effectiveness and audit quality on financial reporting quality in the Sri Lankan context.

Accordingly, the purpose of this research is to investigate the impact of audit committee effectiveness and audit quality on financial reporting quality in the banking sector in Sri Lanka. Hence, the research question of the study is: 'what is the impact of audit committee effectiveness and audit quality on financial reporting quality of the Banking Sector in Sri Lanka?'. This investigation is carried out using a quantitative approach using secondary data and the objective is to provide new knowledge about impact of audit committee on the quality of financial reporting.

The next sections in the paper are organized as follows: Section 2 presents a review of relevant literature and develop the hypotheses of the study. Section 3 briefs the methodology. Results and findings of the study are presented in Section 4 and Section 5 is devoted to the discussion and the conclusion followed by the implications, limitations and the future research in Section 6.

2. Literature Review

2.1 Audit Committee Effectiveness

Audit committee effectiveness is the capacity to continue the independence of the external auditor (Abbott, Parker, & Peters, 2003). Some researchers have stated that the audit committee effectiveness has the capacity to continue the trustworthiness of the financial statements (see for example, Aier, Comprix, Gunlock, & Lee, 2005; Klien, 2002). Any change that is made to the audit committee is related with enhancing the financial reporting quality process (Kim, Segal, Segal & Zang, 2013). Past examinations have evaluated the effect of audit committee effectiveness on financial reporting quality by using audit committee size, audit committee meeting frequency and audit committee financial and accounting expertise (Ayemere & Elijah, 2015; Beck & Mauldin, 2014; Krishnan & Vishvanthan, 2008; Mohammad, 2018; Salehi & Shirazi, 2016; Shankaraiah & Amiri, 2017).

2.1.1 Audit Committee Size

Lin, Li, and Yang (2006) state that bigger audit committees can improve earnings quality by reducing the possibility of occurring financial re-statements and facilitates to closely supervise the financial reporting process. Then, García, Barbadillo, and Pérez (2012) express that when there are more independent directors on the board, it might affect the independence of the audit committee members to solve disagreements due to information asymmetry among managers and shareholders. While assessing the previous studies, many of the past examinations show that the audit committee size is positively associated with financial reporting quality (Shankaraiah & Amiri, 2017; Salehi & Shirazi, 2016). Then, a few researchers have expressed that there is a negative relationship between the audit firm size and the financial reporting quality of the organization (Anderson, Mansi, & Reeb, 2004; Mohammad, 2018). In contrast, few studies in the existing literature state that there is no significant relationship between audit committee size and financial reporting quality (Baxter & Cotter, 2009; Moses, Ofurum, & Egbe, 2016; Pucheta-Martinez & De Fuentez, 2007). As most of the past studies show a positive relationship, first hypothesis of the study was built as follows.

H_1: There is a positive relationship between audit committee size and financial reporting quality of banking sector in Sri Lanka

2.1.2 Audit Committee Meeting Frequency

The audit committee meeting frequency is a critical factor in estimating the audit committee effectiveness when understanding the principal agent disagreements in a company and when the audit committee meeting frequency takes a high value, the committee members can fulfill the responsibility of their jobs successfully (Song & Windram 2004).

Most past studies (i.e., Brayan, Liu, & Tiras, 2004; Shankaraiah & Amiri, 2017) have discovered a positive association between the frequency of audit committee meetings and financial reporting quality. Yet, some studies indicate that the audit committee meeting frequency negatively effects on financial reporting quality (Mohammad, 2018; Salehi & Shirazi, 2016). Different to these investigations, a handful of studies show that there is no significant relationship between audit committee meeting frequency and financial reporting quality (see Baxter & Cotter, 2009; Lin, Li, & Yang, 2006; Vafeas, 2005). As a majority of the investigations show a positive relationship between audit committee meeting frequency and financial reporting quality the second hypothesis of the study was built up as follows.

H_2: There is a positive relationship between audit committee meeting frequency and financial reporting quality of banking sector in Sri Lanka

2.1.3 Audit Committees' Financial and Accounting Expertise

Having the correct individuals as audit committee members is a significant contribution to audit committee effectiveness (Bedard, Chtourou, & Courteau, 2004). As per Cohen, Krishnamoorthy and Wright (2004), it is stated that audit committee members who are having adequate financial and accounting experience tend to support the preparation of financial statements with quality and precise information which will enhance the confidence of the stakeholders of the company.

Most of the studies in extant literature shows a positive relationship between audit committee financial and accounting expertise and financial reporting quality (Wong, 2011; Wu, Wang, & Yin, 2007; Cohen, Krishnamoorthy & Wright, 2004; Salehi & Shirazi, 2016). Meanwhile Mohammad (2018) shows that audit committee financial and accounting expertise is negatively related to financial reporting quality. In contrast to this finding, some studies have stated an insignificant relationship between two variables (Baxter & Cotter, 2009; Lin, Li, & Yang, 2006). Since the majority of the studies in the literature elaborate a positive relationship between audit committee financial and accounting expertise the third hypothesis of the study was developed as follows.

H_3: There is a positive relationship between audit committee financial and accounting expertise and financial reporting quality of banking sector in Sri Lanka

2.2 Audit Quality

As indicated by DeAngelo (1981), audit quality is characterized to be the market surveyed joint likelihood that an auditor will both find misstatements in the client's financial statements and report on that misstatements to the ones who have a stake about the organization. Higher quality audit relates to a lower level of earnings management level and hence a higher caliber of financial reporting (Becker, Defond, & Jiambalvo, 1998; Habbash & Algamdi, 2017).

According to Bliss, Gul and Majid (2011), high quality audits are equipped for finding accounting frauds and mistakes to improve financial reporting quality with the aim of recognizing mal practices in earnings management. Also, Defond and Zhang (2014) elaborate that audit quality gives more assurance on the nature of financial reporting. Past studies have distinguished audit fees and audit firm size as the determinants of evaluating the audit quality on financial reporting quality (AbdulMalik & Ahmad, 2016; Defond & Zhang, 2014; Francis & Yu, 2009; Kabiru & Abdullahi, 2012; Kaklar, Kangarlouei, & Motayassei, 2012; Piot & Janin 2007).

2.2.1 Audit Fees

Audit fees have been used as a variable in estimating audit quality and audit effort can be measured by audit fees which pave the way for a higher financial reporting quality (Abbott, Parker & Peters, 2003). As indicated by DeAngelo (1981), audit fees create a monetary bond between the client and the audit firm when the audit firm charges the audit fees from the client. At the point when an enormous and considerable extent of the audit fees receives from one significant client, the audit firm may act in the wellbeing to hold that client. (DeAngelo, 1981).

The majority of the past investigations report a positive relationship between audit fees and financial reporting quality (AbdulMalik & Ahmad, 2016; Alzoubi, 2016; Lin, Li, & Yang, 2006; Mitra, Deis, & Hossain, 2009; Okolie, 2014). But Ching (2015) expresses no significant relationship between audit fees and financial reporting quality. As most of the past investigations show a positive relationship between audit fees and financial reporting quality the fourth hypothesis of the study could be stated as follows.

H_4: There is a positive relationship between audit fees and financial reporting quality of banking sector in Sri Lanka

2.2.2 Audit Firm Size

Big 4 audit firms have more assets and experienced skilled workers when conducting audits in contrast with non-big 4 audit firms (Li & Lin, 2005) and Big 4 audit firms have a greater level of motivation to identify misstatements and report about them (Houqe, Ahmed, & Van Zijl, 2017). While evaluating past studies, it perceives that the big 4 audit firms offer more noteworthy service to their clients than non-big 4 audit firms as the majority of the examinations show a positive relationship between audit firm size and financial reporting quality (Lopes, 2018; Rusmin, 2010). Meanwhile, some studies state a negative relationship between audit firm size and financial reporting quality (Alves, 2013; Kaklar, Kangarlouei & Motayassei, 2012). In contrast, Abdul Rahman and Haneem Mohamed Ali (2007) found an insignificant relationship between two variables. As most of the studies show a positive relationship between audit firm size and financial reporting quality the fifth hypothesis can be stated as follows.

H_5: There is a positive relationship between audit firm size and financial reporting quality of banking sector in Sri Lanka

2.3 Financial Reporting Quality

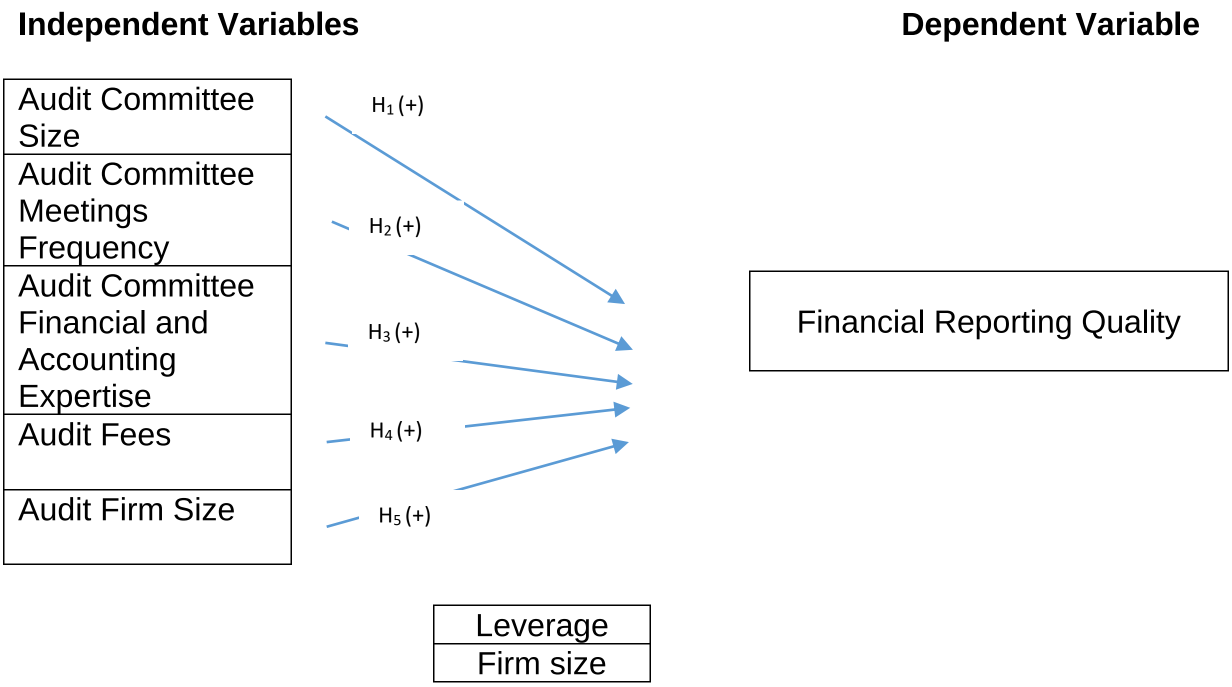
When the quality of financial reporting is high the investors can get more advantage. High financial reporting quality is required to decrease information asymmetry among organizations and limits managers' inspirations in controlling and misinterpreting earnings (Chen et al., 2011).
Financial reporting quality variable of this study is measured by the discretionary accruals using Modified Jones Model (1995).

$TACC_{it} = NI_{it} – CFO_{it}$
$TACC_{it}$ = Total accruals for company *i* in year *t*
NI_{it} = Net income of company *i* for year *t*
CFO_{it} = Net cash flow from operations of company *i* for year *t*
The above calculated $TACC_{it}$ is used in the following equation.
$TACC_{it} = α_1 (1/TA_{it-1}) + α_2 Δ\ Rev_{it} Δ\ Rec_{it}) + α_3 (PPE_{it}) + €_{it}$
Where,
$ΔRev_{it}$ = Change in revenue for company *i* in year *t*
$ΔRec_{it}$ = Change in receivables for company *i* in year *t*
PPE_{it} = Net property, plant and equipment for company *i* in year *t*
TA_{it-1} = Total assets for firm *i* in year *t-1*
The variables are deflated by lagged total assets (TA_{it-1}) as shown in the following equation. Then the coefficients will be calculated.
$TACC_{it}/ TA_{it-1} = α_1 (1/ TA_{it-1}) +α_2 Δ\ Rev_{it} -Δ\ Rec_{it}) / TA_{it-1}] +α_3 (PPE_{it}/ TA_{it-1}) + €_{it}$
Non-discretionary accruals ($NDAC_{it}$) will be estimated by using the calculated coefficients.
$NDAC_{it} = α_1 (1/ TA_{it-1}) +α_2 Δ\ Rev_{it} –Δ\ Rec_{it}) / TA_{it-1}] +α_3 (PPE_{it}/ TA_{it-1}) + €_{it}$
Then the discretionary accruals ($DACC_{it}$) are calculated by using the following equation. Here the non-discretionary accruals are deducted from the total accruals.
$DACC_{it} = TACC_{it} - NDAC_{it}$
$FRQ_{it} = DACC_{it}$

3. Methodology

To investigate the relationship between the impact of audit committee effectiveness and audit quality on financial reporting quality, all the 26 LCBs and 6 LSBs were selected as the sample. But due to the unavailability and insufficiency of the data, 2 banks were excluded from the population to select the sample. For this research, secondary data were collected from annual reports of the banks for 5 years from 2014 to 2018. Statement of financial position, Statement of profit and loss and other comprehensive income, Notes to the financial statements, Audit report, corporate governance disclosures are the main components that were used for the data collection purpose of this research.

Figure 1 : Conceptual Framework



The study uses the following panel data regression model to draw empirical results to test hypotheses.

$$FRQ_{it} = \beta_0 + \beta_1\, ACS_{it} + \beta_2\, ACM_{it} + \beta_3\, ACE_{it} + \beta_4\, AF_{it} + \beta_5\, AFS_{it} + \beta_7 LV_{it} + \beta_9\, FS_{it} + \varepsilon_{it}$$

Where;
FRQ_{it} - Financial reporting quality of the firm *i* for the year *t*
ACS_{it} - Audit committee size of the firm *i* for the year *t*
ACM_{it} - Audit committee meetings frequency of the firm *i* for the year *t*
ACE_{it} - Audit committee financial and accounting expertise of the firm *i* for the year *t*
AF_{it} -Audit fees of the firm *i* for the year *t*
AFS_{it} - Audit firm size of the firm *i* for the year *t*
LV_{it} - Leverage of the firm *i* for the year *t*
FS_{it} - Firm size of the firm *i* for the year *t*
ε_{it} - Error term

Table 1: Operationalization of Variables

Variable	Acronym	Definition and measurement
Audit Committee Size	ACS	The number of members of the audit committee elected by the board of directors.
Audit Committee Meeting Frequency	ACM	Ratio of the number of audit committee meetings to total meetings by the Board of Directors
Audit Committee Financial and Accounting Expertise	ACE	Ratio of the number of qualified members in accounting and finance to all the members in the audit committee.
Audit Fees	AF	The natural logarithm of audit fee paid to the auditor.
Audit Firm Size	AFS	KPMG, EY, DELOITTE, and PWC are the big four audit firms. If the audit firm is one of big four firms 1 is given and for other non-big 4firms 0 is given.
Leverage	LV	The ratio of total debt to total assets
Firm Size	FS	The natural log of total assets

4. Results and Findings

Correlation and regression analyses were carried out to draw statistical evidence to test hypotheses of the study. Prior to the analysis, we checked and rectified few extreme values in the data. Before conducting correlation and regression analyses, we tested whether the multicollinearity issue present in the data related to independent variables of the study. Lower correlation coefficients among independent variables below 0.9 ensure the absence of the multicollinearity issue in the study. Table 2 summarizes correlation results.

Table 2: Correlation Results

Correlation	Coefficient
Audit committee size and financial reporting quality	-0.118
Audit committee meeting frequency and financial reporting quality	-0.291^{α}
Audit committee finance and accounting expertise and financial reporting quality	-0.159^{β}
Audit fee and financial reporting quality	-0.214^{α}
Audit firm size and financial reporting quality	-0.066
Leverage and financial reporting quality	0.044
Firm size and financial reporting quality	0.699^{α}

Notes: Number of observations is 160; significance levels are $^{\alpha}$ = 0.01 and $^{\beta}$ = 0.05

The correlation between audit committee size and financial reporting quality reports a weak, negative and statistically insignificant relationship. Correlation results of Table 2 indicate a weak negative and statistically significant relationship between audit committee meetings and financial reporting quality. Furthermore, the correlation between the variables audit committee financial and accounting expertise and financial reporting quality, record a statistically significant negative relationship. In examining the correlation between audit fees and financial reporting quality, it can be noted a weak negative and statistically significant relationship. But the correlation between audit firm size and financial reporting quality reports a very weak negative and statistically insignificant relationship. Accordingly, none of the hypotheses are supported by the correlation results of the study. Table 3 summarizes the regression estimates which could be used test the hypotheses in the second phase.

Table 3: Regression Estimates

Model: $FRQ_{it} = \beta_0 + \beta_1 ACS_{it} + \beta_2 ACM_{it} + \beta_3 ACE_{it} + \beta_4 AF_{it} + \beta_5 AFS_{it} + \beta_7 LV_{it} + \beta_9 FS_{it} + \varepsilon_{it}$

Variable	Coefficient	Std. Error	*t*-Statistic	*p*-value
C	4.00	9.88	0.40	0.68
ACS	0.04	0.20	0.21	0.83
ACM	-0.02	0.74	-0.02	0.97
ACE	-2.76	4.68	-0.58	0.55
AF	-0.06	0.41	-0.15	0.87
AFS	-2.29	0.83	-2.76	0.00^{α}
LV	1.45	0.95	1.51	0.13
FS	0.85	0.40	2.09	0.03^{α}

Adjusted R^2 = 0.86; F-statistic = 27.76^{a}

Note: Number of observations is 160; α = significance level 0.01; Regression estimates are based on random effects model according to the test results of Hausman Specification Test

Regression estimates presented in Table 3 above indicate a statistically significant negative impact from audit firm size and financial reporting quality of the selected firms for the study. However, as stated in the correlation analysis none of the hypotheses are supported in the regression analysis too. *F*-statistic of 27.76 indicates robustness and efficiency of the model to analyze the collected data.

Adjusted R-squared value of 0.86 indicates that all explanatory variables in the model jointly explain to the extent of 86% variation of the financial reporting quality.

5. Discussion and Conclusion

As per the study results (see Table 3), audit committee size shows no significant relationship with financial reporting quality in the banking sector in Sri Lanka. This does not support the hypothesis that there is a positive relationship between audit committee effectiveness and financial reporting quality. Baxter and Cotter (2009), and Pucheta-Martinez and De Fuentez, (2007) also reported a similar insignificant relationship between audit committee size and financial reporting quality. This insignificant association may occur because of uncertainties in the environment and due to the strict rules and regulations of the Central Bank of Sri Lanka that the banking sector must comply, it should be crucial to ensure the financial reporting quality and to maintain the financial stability within the banking sector despite the factor having an audit committee and its size. This is also supported by Pucheta-Martinez and De Fuentez, (2007) as they conclude that the presence of audit committee and its size may not generate a greater financial reporting quality.

Regression estimates in Table 3 shows an insignificant relationship between audit committee meetings and financial reporting quality in the banking sector in Sri Lanka. This does not support the hypothesis on the positive relationship between audit committee meetings and financial reporting quality. Similar to this insignificant association, some past studies such as Lin, Li, and Yang (2006) and Vafeas (2005) have found no statistically significant relationship between audit committee meetings and financial reporting quality. This insignificant relationship might occur as all the audit committee members sometimes may not be able to participate in the audit committee meetings of the bank.

Results reported in Table 3 indicate that the relationship between audit committee financial and accounting expertise on the financial reporting quality in the banking sector in Sri Lanka demonstrates no significant relationship between the two variables. This does not support the hypothesis of the research on the positive relationship between audit committee financial and accounting expertise and financial reporting quality. A similar insignificant relationship is reported in studies conducted by Baxter and Cotter (2009). An insignificant relationship between audit committee financial and accounting expertise and financial reporting quality may happen as the dependent variable financial reporting quality is measured as a proxy of earnings management in this study. This finding is also supported by Baxter and Cotter (2009).

Audit fees also show no significant impact on financial reporting quality in selected sample banks in Sri Lanka. According to the developed hypothesis of this research there is a positive relationship between audit fees and financial reporting quality. But the hypothesis is not supported as there is no significant relationship between audit fees and financial reporting quality. This demonstrates a higher audit quality as charging a higher audit fee does not have an impact to improve the financial reporting quality in the banking sector in Sri Lanka. This insignificant relationship between two variables is evident in past studies reported in the literature (Ching, 2015; Chung & Kallapur, 2003). The reason for this insignificant relationship may occur as most of the banks (more than 87%) in the banking sector are being audited by Big Four audit firms and their main objective may be to keep a higher financial reporting quality rather than focusing on charging a higher audit fees from the client. This finding is also supported by Ching (2015).

As per the regression estimates included in Table 3, audit firm size shows a negative significant association on financial reporting quality in the banking sector in Sri Lanka. But this does not support the hypothesis on the positive relationship between audit firm size and financial reporting quality. This negative relationship between audit firm size and financial reporting quality is supported by past studies in the literature (Alves, 2013; Kaklar, Kangarlouei, & Motayassei, 2012). A significant relationship between two variables may happen, as the audit firm tries to increase the inspection on the bank audit after the identification of nature of the organization, internal controls, and possible risks to express a true and fair view on the status of financial statements regardless of the factor whether the audit firm is a Big Four firm or non-big four firm. A similar finding is supported by Kaklar, Kangarlouei, and Motayassei (2012).

Results of the analysis indicate that the leverage has no significant impact on the financial reporting quality in the banking sector in Sri Lanka. This conforms with past findings reported in the literature (AbdulMalik & Ahamed, 2017; Tonye & Sokiri, 2020). As indicated by the results, firm size has a positive significant relationship on the financial reporting quality in the banking sector in Sri Lanka. This means when firm size increases, there is a possibility of having a higher financial reporting quality. This is also supported by past studies in the literature (see Nelson & Devi, 2013; Salehi & Shirazi, 2016).

6. Implications, Limitations and Future Research

Findings of this research would contribute to the extant literature by providing a clear insight into the research topic of the impact of audit committee effectiveness and audit quality on financial reporting quality in the banking sector in Sri Lanka. Further the study would contribute to the practice by providing necessary and vital information to the regulatory institutions of the banking sector in Sri Lanka to make decisions to enhance financial reporting quality and to enhance the disclosure requirements in the annual reports to give a better comprehension to the users of the financial statements. for instance, the investors may get the opportunity to get a clear idea by studying financial statements before making investments.

The scope of this study is limited only to the banking sector including LCBs and LSBs which are registered in CBSL. Due to the unavailability of the data, this study does not include 2 banks out of the population which is 32. The time frame which was considered for this study is from the year 2014 to 2018 for 5 year’s period and can be identified as a limitation of this study. Results may have changed if more than 5 year’s data is used. The study used the modified Jones Model (1995) to measure the financial reporting quality through discretionary accruals as a measure of earnings management and as the modified Jones Model (1995) measures the accruals with errors, it may affect the results of the study. Furthermore, this study is using annual reports of the sample banks as the data collection method.

The findings and results of this research pave the way for future research. When analyzing the impact of audit committee effectiveness and audit quality on financial reporting quality, this study only focuses on the banking sector in Sri Lanka. Future research can focus on other sectors. To avoid the limitations in the modified Jones Model (1995) future researchers can use the Performance Matched Modified Jones Model (2005). Further, this research was conducted by using only secondary data (annual reports) and few variables. Future research can consider using primary data (such as interviews and questionnaires) and additional variables.

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