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Impact of Corporate Governance Measures on Earnings Quality: Evidence from Pakistan

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Abstract
The purpose of this study is to examine the impact of corporate governance on earnings quality of the manufacturing firms listed on Karachi Stock Exchange. Whereas, earning quality of the firm has been addressed by earnings management and discretionary accruals used to measure the level of earnings management. In this study Jones Model has been used to calculate discretionary accruals. Moreover, we had used four characteristics to capture the effect of corporate governance like audit quality, CEO duality, board size and gender diversity and two control variables firm size and leverage. Findings of the study disclose significant negative impact of audit quality and board size on earnings management, while the relationship between firm size and earnings management is positively significant.
Keywords: Earnings Management, Corporate Governance, Pakistan

Introduction

Earning quality for any firm is like a back bone. Every firm wants to attain maximum level of quality in its earnings. Firm's quality has been affected in various ways. As Pakistani firms are majorly owned and governed by family's structures. Therefore, earnings quality is debatable topic in the present period and it has become a dilemma for analysts, accounting experts and managers as well. Due to the reason managers are trying to achieve the defined objective of the firms by maintaining the growth and sustainability in earnings in order to their protection. On the other hand, analysts are engaged to enhance the quality level for attracting maximum investors to raise the capital of the portfolio. Therefore, it is too essential for both mangers and expert analysts to maintain quality in the earnings for securing settled targets; in shape of both profit maximization and investors grabbing. Prior studies translated that earnings management is the consequence of earnings quality. So, initially, it is need to comprehend that how earnings management is the proxy for earnings quality.

Earlier literature had defined earning quality in many aspects but still there is no exact definition developed in the previous literature but it had attained great attention in the recent years by accounting researchers and other participant wanted to analyze the quality in financial reporting process (Ayadi & Boujelbene (2014). Earnings quality is described for useful decision from on the basis of true information. So, it has alone no meaning; earnings quality is defined only in the circumstance of decision taking. Second, it is defined due to the true information of annual reports. So generally it is recommended that impact of all above mentioned definition's presence in financial reporting is very critical for achieving true information in financial reports in order to attract number of shareholders to boost up firm's market share.

Thus in view of above earning quality possessed multidimensional features its definition varies by researchers as Bernstein Siegel (1979) categorize earnings quality into three concepts: conservatism, discretionary costs, and variability of earnings resulting from management decisions or the economic cycle then Lev (1989) defined earnings quality as the predictive power of financial variables, he explained that higher earnings quality requires that anticipated events potentially affecting a firm's future cash flows are reflected in the firm's current earnings and values. Further Bricker, Previts, Robinson, and Young (1995) explored earnings quality by analyzing sell-side financial analysts' reports. The result showed that financial analysts consider recurring, consistent and predictable earnings as high quality earnings. Schipper and Vincent (2003) also added their contribution and suggested seven measures of earnings quality: persistence, predictability, variability, ratio of cash from operations to income, changes in total accruals, discretionary accruals, and accruals to cash flows. Francis et al. in (2004) build further extension and classified seven earnings attributes into either accounting based or market-based attributes and categorized discretionary accrual, earnings persistence, earnings predictability, and earnings smoothness as accounting class because these are measured using accounting information only, whereas value relevance, timeliness, and conservatism are referred to as market-based attributes since these are based on the relation between accounting earnings and returns. As above in view, there is no single pet definition of earnings quality (Dechow et al. 2010). Therefore, out of four accounting based measures of earnings quality including; discretionary accruals, earnings persistence, earnings predictability and earnings smoothness, this study will pick the first accounting base measure i.e, earnings management or discretionary accruals to quantify the quality of earnings of Pakistani non-financial listed firms on KSE.

As management is answerable to owners about the performance of the firms so the managers involve in management practices as per their authority level to smoothen the results. Earning management is the art of converting and manipulating the results by managers as they want to smooth the earnings. That leads the overall quality in both directions low and high. Literature has developed two thoughts on earnings management. But it has been cleared that quality level effected in both direction and it further generates the concept of corporate governance to promote quality by reducing irregular and non-accounting practices in the firms.

High quality corporate governance strengthens the standard and long term performance of the firm. Corporate governance makes sure the clarity, answerability, fairness, sustainable company's financial performance, shareholder's confidence and the maximization of the shareholders wealth. Shortly, corporate governance used to control and direct the matters of the firm for serving and protecting the individuals and all stakeholders. Due to this corporate governance has become a critical and debatable topic in developed and developing economies in the entire world and it is also being documented in literature by many researchers.

As agency theory depicts that corporate governance importance felt from the clashes of benefits between those who manage the internal work of and those who invest money as a capital for profit maximization. Berle & Means (1932) squabbled with the intention of the separation of ownership from control escort to discrepancy of concentration mainly between isolated administrator and shareholders. The managers might adopt sub-optimal strategies and spend more money on the luxury projects rather than on those projects which give more value maximizing.

Corporate governance alarms the association along with the controlling shareholder, minority shareholder, board's director and administration. Securities & Exchange Commission of Pakistan (SECP) has developed the code of firm's governance that added more value to corporate governance impact on firms. However to vanish this agency conflict for the satisfaction of interest of shareholders, managers should pursue strategies that are consistent with maximizing shareholders' wealth through enhancement of earning quality of the firm. Due to this conflict information tie up in financial statements had adversely effected. As corporate governance capture no of parameters to exercise its implication but these instruments are generally categorized into internal and external mechanisms. Yet there is no agreement for corporate governance on earning quality but more than a few findings have found significant association of corporate governance and earnings management for fabricating & sustaining the earning quality of the firms (Liu & Lu (2007) & Doukakis, (2011). As mentioned above that this study will address the relation of corporate governance from quality by earnings management. So, the remainder of this study is shaped up as follows: Section two describes the literature review and next section will address the research design and methodology. Final section will add the results and conclusion.

Literature review

Earnings Management:

In literature earnings management has been argued in two directions. First, Bieldleman (1973) and Lipe (1990) said the earnings management is used to condense variability of earning and managers works on to reduce uncertainty for improving earnings predictability of the firms, that further leads to maximize the shareholders benefits and enhance the quality of earnings.

On the other side second concept on earnings management is documented by (Schipper & Vincent (2003) and stated that manipulation in earnings is totally against the accounting practicing and badly effects shareholder wealth and trust. They also added that same practice is totally in contrast of faithfulness. As above discussed that earnings management is the measure of earnings quality that how quality can be enhanced by the use of irregular practices of managers. In spite that both above mentioned thoughts depicted that managers use discretionary accruals as they want to attain their favorable results rather shareholders. Dechow et al (1995) also complemented that discretionary accruals are basic tool for earnings management. Further, many contributions of researcher have been added on earnings management.

Earnings management is also defined as the use of managerial judgments for altering the financial reports to mislead the external shareholders and all stockholders also. Managers therefore, estimate future economic events at their judgment and these are reflected in firms' financial reports. And managerial shareholders raised that all differences just on behalf of judgments and institutions. Peasnell, Pope, & Young worked in 2005 to study earnings management concept and found that in earnings management, accounting choices are incorporated to reflect either increased or decreased income. On the other side, when the benefits of shareholders and managers deviate, that leads raise to moral hazard. Almilia in 2009 stated that agency theory is an important element in understanding financial reporting. Agency theory holds that, in the presence of information asymmetries, managers will choose to make a set of decisions that maximize their usefulness.

Above in view earnings management is defined in terms of absence of manipulative practices. That is the reason earnings lost the actual strength and couldn't be the beneficiary for the end users and external shareholders due the intentional manipulation of earnings by managers (Matis et al. 2010). Therefore, earnings persistence and earnings predictable can never be of high quality if the final number were obtained by from earnings management (Dechow and Schrand 2004). And accounting literature suggested that accruals are normally used as a means to assess the level of earnings management. Literature divided accruals in two parts abnormal accruals and normal accruals. As this study capture the effect of quality by corporate governance and ownership structure. Therefore, abnormal accruals are more important for empirical findings in this study and they are defined as the result of earnings management in accounting practices or it is difference between actual and expected non cash expensed /accruals. Higher abnormal accruals drive to down the level of quality in earnings. Because the firm's process to find out non cash expensed is not predicable but abnormal accruals are seems to be optional by the act of earnings management.

Accrual Measures has been used many of prior studies to capture quality in reported earnings. Many researchers have used their own ways to quantify earnings quality via accruals. Jones in 1991 used a very common approach that is to divide accruals in normal and abnormal category based on forecast model of total accruals. Researchers are normally used 4 models to identify earnings management or discretionary accruals. The most popular method is the model mentioned above i.e to split the total accruals into normal and abnormal categories (Burgstahler , Dichev, 1997a, b Haw and Ho, and Li, 2011).

Literature treated accruals as non-cash expense and more higher abnormal accruals lead to lower earnings quality because accruals process in the firms are fewer expected and irregular accruals are treated as discretionary by managers during earnings management. Previous literature suggested that private information is the foundation of abnormal accruals and Perotti, P et al, in 2014 further suggested that rational expectations market models describe that the information components offsets the earnings management component due to the own practice of rationale investors about management incentives. So far abnormal accruals have very less quantity to capture market reaction and abnormal accruals are very less useful proxy for earnings quality measures.

And the second renowned accruals measure is **accruals quality** and it is defined as the difference between cash from operations and recorded earnings of business (Richardson et al. in 2001). Similarly, Johnston in 2009 reported that accruals quality can also be measure through error obtains from accruals estimation. Therefore above mentioned first way emphasized on magnitude and second focused on errors of accruals estimation, are used as proxy for earnings quality (Desai et al. 2006). So far higher the value obtained from each way, indicates poor earnings quality of the firms and less the value captured from each way show high earnings quality in the firm. Dechow and Dichev in 2002 also supported accrual quality as a measure of accruals. In this study discretionary accruals are being measured by Modified John Model, which is being given by Dechow et al (1995) and according to her this model is more powerful testing of earrings management.

Corporate Governance and Earnings management

Corporate governance in 21 century after the collapse of the firms like Enron and World Com is again a critical business issue. The decision makers now acknowledge that the matter of governance principles could promote persistence with encouragement in investments and also it directs to economic growth. Corporate governance is a set of regulation and control tools which will lead to achieving the goals, clearness, fairness and analyzing stakeholder's right to manage activities, policy, arrangements, processes, traditions and systems. Peak quality of reporting earnings has lead to financial standing of a company through annual reports of performance during its defined fiscal year in a suitable and sincere approach. If manager's goals are fully in line with stockholder's benefits or conflict of interests does not exist between them, there is no need for managers to depict imaginary reports of company's position to stockholders (K. Sivaramakrishnian et al, 2008). Shiri M.M. et al. in 2012 added that corporate governance is has ability to reduce agency cost and it leads to promote quality in the reported earnings for attaining high value in the market. Karmanaou, I. and N. Vafeas (2005) added that firms having effective governance are more likely to make or update a management forecast. Wang Huacheng and Huang Xinjian (2007) use the ST listed companies as in the study and analyze the relationship between the earnings management and the corporate governance structure, the results show that the degree of concentration and Earnings Management has a positive correlation.

This study will use the following proxies to assess corporate governance level in listed Pakistani firms:

Audit Quality: Audit quality implementation is like a backbone for all firms. It has direct positive relationship with quality in earnings and indirect & negative relationship with earnings management. Basically, audit firms must remain independent to be able to carry out the oversight in the firms functioning. In Pakistan it audit quality is being considered good when audit of the firm is carried out by top five audit firm. Alzoubi et al, in 2012 & Mansoor, Ahmad Ahmad-Zaluki, and Osman in 2013 also conclude that larger audit committees with a superior amount of independence carried out better as oversight bodies. As audit of the firms filled huge gape of mistakes during internal operations for maximizing profit rate. Therefore, the firms who are ensuring the audit quality would be the higher quality producer firms. Particularly in Pakistan the firms who made their audits form top give best audit companies would be considered better with advance creditable. In this way shareholders trust on them and invested huge capital for profit making. Carcello et al again in 2006 intimated a trade-off between financial expertise and other corporate governance mechanisms. One more study repeated the findings of prior researchers and informed that independent audit of the firm can down opportunistic earnings manipulation (Turner and Vann, 2010). So, the study hypothesis is as:

H1: Audit quality has significant impact on earnings quality.

CEO duality: CEO duality means the person who is performing the duties of chief executive officer of the firm along the representation in the board of directors Literature suggested that separating the position of CEO and chairman of firm enhance the performance of the firm and also help in minimizing agency costs. A CEO duality is a significant board controller. It relates circumstances wherever the firm's CEO plays critical roles as a director of board. Two challenging has to face on the subject of CEO duality base on the consciousness of whether a firm is superlative serve by muscular headship (stewardship theory), or by monitoring efficiently (agency theory). The main purpose of this duality is to dish up as a substitute for how much control the chairman own.

In view of above, we derive the following hypothesis in the sense that CEO duality may step in to promote quality in earnings. Therefore, the study predicts that CEO duality has a positive effect on earnings quality, as hypothesized below

H2: CEO duality has significant impact on earnings quality.

Board Size: Small boards are considered to be fewer influential and efficient as compare to the boards included large no of directors in the board Pearce & Zahra (1991). The same is also contributed by Singh and Davidson in 2003 and found that the association between board size and utilization of asset ratio is positive and significant. Moreover, they end up and suggested that less agency cost represent the high rate of asset utilization.

Above in view, we can build the argument that in any aspect structure of board size effects quality and efficiency of firm's performance. Various more studies like Ferraz et al. in 2011 Brazil, added that if the size of the Board is very small, the monitoring team is too smaller, and greater chance of receiving remunerations would be there for earnings management and are more easy access to asymmetry information (Azofra et al. 2005; Brick et al. 2006). On the other side, a larger size of Board assumes a better supervision of the management and a incorporate maximum quality in corporate decisions (Pearce and Zahra 1992). In this regard, Chin et al. in 2006 initiated a study consisted on a sample of 313 firms from Hong Kong and found a negative relationship between the size of the Board and earnings management.

Chaharsoughi T.M, et al in 2013 discussed with reference of the Iranian Code of Corporate Governance confirmed that the best possible number of board size should be suitably determined by the whole board for ensuring that there are enough members to take responsibilities and assigned duties. Further, Abdul Rahman & Mohamed Ali, 2006 said that a big size of board can play tremendous role to stop corporate failure. However, a large board size may make it hard for members to have well-organized. Goodstein, Gautam, and Boeker (1994) disagreed and added that smaller boards of 4-6 members might be more useful, as it is more helpful in quick decision making, . Again Zahra & Pearce, 1989 found larger boards are competent for monitoring the actions of top management and increase the earnings quality (Xie et al., 2003; Peasnell, Pope, & Young, 2001). Therefore, the study forecast that board size has a positive effect on earnings quality.

H3: Board size significantly impacts on earnings quality.

Gender Diversity: Gender diversity is the simple concept that is to include the proportion of female director in the board size of firms. Previous studies examined the relationships between the proportions of female as a board of director in the board size of the firm. Adams & Ferreira in 2009 intimated that female directors are more likely to be the in the board to make more effort to control and monitor managers performance. Adams et al. in 2010 also raised his statement as per empirical evidence that female free neutral thoughts are significant for inspection of opportunistic activities and providing better quality in annual reports to meet the demand of true financial information. The previous discussion constructs the next hypothesis as follows:

H4: Gender diversity significantly impacts on earnings quality.

Research Methodology

This section describes the type of data collected, sources of data, period of the data and methodology used to examine this relationship, the method of measuring proposed variables and research model and methods.

Sample

The sample has been taken from Karachi Stock Exchange 100 index including 70 non-financial listed firms and excluded financial companies and excluded those firms for which we could be able to found required data. The data for the independent variable i.e corporate governance (Audit quality, CEO duality, Board size & Gender

Diversity) and have been collected form annual financial reports of non-financial Pakistani listed firms on KSE. Further, for the purpose to test hypothesis, following models have been used:

Model for the Dependent and Independent Variables
Earnings Quality (Dependent Variable)
In this paper earnings quality has been addressed by its proxy i.e. earnings management. In literature accruals are used to measure earnings management. Accruals can be calculated by two approaches as follows:

a. Balance sheet approach
b. Cash flow statement approach

Balance Sheet Approach
In this approach accruals can be measured by the following formula equation as Jones (1991) & Healey (1985) have used same formulas & equation in their empirical work.

$$ACC_t = \Delta CA_t - \Delta Cash_t - \Delta CL_t + \Delta DCL_t - DEP_t$$

Where above equation represents the following:
$\Delta CA_t =$ Change in current assets in year t
$\Delta Cash_t =$ Change in cash & cash equivalents in year t
$\Delta CL_t =$ Change in current liabilities in year t
$\Delta DCL_t =$ Change in debt included in the current liabilities in year t
$\Delta DEP_t =$ Depreciation & amortization expense in year t

Cash Flow Statement Approach
Cash flow approach has also its significance for calculating accruals and following equation is being used in literature:

$$ACC = N.I_t - CFO_t$$

Where above equation represents the following:
$N.I_t =$ Net income in Year t
$CFO_t =$ Cash flows from operating activities in year t

As mentioned above both approaches are used to calculate accruals but in literature most of the researchers have used cash flow approach as Collins & Hriber stated that cash flow approach is better to find accruals from balance sheet approach. On the other side Judy S.L (2000) used balance sheet approach but he further added the reason to use balance sheet approach that data of cash flows from operations was not available of that specific period. But in this study we have successfully collected data from cash flow statement from 2007-2013. Therefore, in this study accruals are being calculated from Cash Flows Statement Approach. As literature showed that accruals are not related to earnings management and therefore, accruals are being divided in two parts discretionary accruals and non-discretionary accruals. So, discretionary accruals can be obtained by subtracting non-discretionary accruals from total accruals.

Moreover, many models and procedure have been exercised to measure discretionary accruals. In this study modified jones model (1995) is used to calculate discretionary accruals from the error term of the regression model.

Calculation of Discretionary Accruals

$$ACC_{i,t} = \alpha + \beta_1(\Delta REV_{i,t} - \Delta Rv_{i,t}) + \beta_2 PPE_{i,t} + \varepsilon_{i,t}$$

Whereas,
$ACC =$ Total accruals
$\Delta REV =$ Change in revenues
$\Delta Rv =$ Change in Receivables
$PPE =$ Gross, property plants and equipments
$\varepsilon_{i,t} =$ Errors terms (We use this error term as discretionary accruals)
Therefore our final general forms of the model as follows:

$$\sigma = f(EM, AQ, CD, BS, GD, LV, FS)$$

Econometric Model and Analysis
Panel data has been used in this study. Panel data analysis has its own significance because of its feature that it can analyze different cross sections over the period of time. Our econometric model is as follows:-

$$DA = \alpha_0 + \alpha_1 AQ_{it} + \alpha_2 CD_{it} + \alpha_3 BS_{it} + \alpha_4 GD_{it} + \alpha_9 LV_{it} + \alpha_{10} FS_{it} + \epsilon$$

Where
DA = Discretionary accruals
AQ = Audit quality

CD = CEO duality
BS = Board size
GD = Gender diversity
LV = Leverage (Used as control variable)
FS = Firm Size (Used as control variable)

Results and Discussion
This section contains the results and discussion regarding the descriptive analysis, correlation matrix and panel data regression of our model.

Descriptive Statistics
Descriptive statistics have been calculated for all individual variables. By descriptive statistics, behavior of the data is described as under:

Table 1 shows descriptive statistics of dependent and explanatory variables. The mean value of discretionary accrual is 0.7518 with maximum value 1. Audit quality has average of 0.710, it shows huge portion of Pakistani listed firms have been audited by big 5 auditor firms. Further descriptive of CEO duality disclose that higher number of firms have their CEO with dual positions. Moreover, board size of Pakistani firms is in between 6 & 15 and the average point is 8.433. On average the proportion of women director in board is 0.07.

Table: 1

Variable	Mean	Maximum	Minimum	SD	Skewness	Kurtosis
DA	0.75185	1	0.06119	0.236252	0.900701	2.724862
AQ	0.710204	1	0	0.454131	-0.92669	1.85875
CD	0.963265	1	0	0.188302	-4.92548	25.26036
BS	8.432653	15	6	1.655552	1.325744	4.607679
GD	0.071235	0.571429	0	0.127917	1.809205	5.596377
FSZ	15.88865	19.66607	12.08671	1.350555	0.256246	2.763902
LEV	0.897768	51.52	-2.65	3.686388	9.646535	111.4199

Correlation Matrix
Table 2 of correlation matrix shows that discretionary accrual has weak negative correlation with audit quality and board size. Further, CEO duality and gender diversity both are positively related with discretionary accruals. Table shows the correlation for all explanatory variables used this study. All the values are less than cut point and there is no strong correlation ($r > 0.86$) which shows that there is no multicollinearity.

Table 2

	DA	AQ	BS	CD	GD	FSZ	LEV
DA	1						
AQ	-0.08	1					
BS	-0.17	0.22	1				
CD	0.04	-0.03	0.06	1			
GD	0.15	-0.28	-0.30	-0.20	1		
FSZ	0.18	0.33	0.33	-0.04	-0.17	1	
LEV	0.06	0.00	-0.07	0.03	0.19	0.05	1

After analyzing descriptive and correlation analysis, now we are going to regress characteristics of corporate governance on discretionary accruals. For this we will use the panel data analysis as panel data estimation is considered to e an efficient analysitcal metho in handling econometric data. Panel data set is expressed by a sample that contains N cross-sectional units that are observed at different time periods. Simple linear model with explanatory variable is as under:

$$Y_{it} = \beta X_{it} + \alpha + \varepsilon_{it}$$

Y = dependent variable where i= Firm & t = time
B = Coefficient of the independent variable
X_{it} = First independent variable
α = Intercept for each firm
ε_{it} = Error term
The sample liner panel model is estimated by using three different models:

a) Common Effect
b) Fixed Effect
c) Random Effect

In this study the results of common effect model has shown mix response. Then we applied redundant fixed effect test to select between common effect or fixed effect and we found F >10 with P value < 0.05 that further leads to make selection between fixed and random effect model by Housman Test. Moreover, Housman test gives significant result with best fit model. These results further confirm to use Random effect model for final testing the impact of corporate governance on discretionary accruals is as follows:

Random Effect Model
Regression Result
The random effect model showed the following results. The F statistics is 10.3026 and p-value is also significant which informs that the model is fit. The value of coefficient determination R^2 is 25.47 percent. It shows that all independent variables caused 25.47% variation in earnings management. However there are no other factors which are influencing the dependent variable because our C is statistically insignificant. Therefore, regression results can be used to predict the impact of board characteristics on technical efficiency

The result of random effect model directed that the audit quality and board size of the firm has the negatively significant impact on discretionary accruals respectively (β=-0.292 & -0.065; $p < 0.05$); which implies that big five auditor firms in Pakistan can play major role for promoting quality in earnings and minimum no of director in the board is good for quality of earnings by cutting down the management practices. Further, regression model caught the positive affect of firm size as a control variable on discretionary accruals (β= 0.86 $p < 0.05$). However, CEO duality and gender diversity have no significant impact on discretionary accruals along with leverage as a control independent variable respectively (β= 0.0087, 0.0126 & .0086 ; $p > 0.05$).

Table 3

Variable	Coefficient	Std. Error	t-statistics	Prob
C	0.0161	0.0234	0.6899	0.4908
AQ	-0.0292	0.0079	-3.6857	0.0002
CD	0.0087	0.0099	0.8788	0.3795
BS	-0.065	0.019	-3.421	0.0003
GD	0.0126	0.0112	1.1255	0.2604
LV	0.0086	0.0173	0.4981	0.6181
FS	0.086	0.014	5.714	0.000
R-Squared	0.2547			
Adjusted R-Squared	0.2340			
F-statistics	10.3026			
Prob(F-statistics)	0.0000		**Durbin Watson Stat**	1.7981

Discussion of Results
In view of above mentioned results, it is concluded that two characteristics of corporate governance explicates the discretionary accruals for measuring the quality of earnings of Pakistani non-financial listed firms. As in previous studies, there are diverse results between corporate governance and earnings management. And the result of this study has also showed mix response of independent variable towards earnings management and stated that CEO duality, gender diversity and leverage as control variable have not any significant effect on earnings management. While, audit quality, board size, board size and firm size (control variable) are found negative significant relation with earnings management except firms size that is positively related with earnings management. That reflects that proxies of corporate governance can play a constructive role to promote earnings quality when these proxies used in very high manners in the firms operations. If we decrease the number of directors in board size that will leads less manipulation and earnings management. Similarly, role of earnings management will be decline when the firms are being audited by top ranked audit firms. Further, these findings are partially in line with many of other researches in the literature. For instance Abdullah F, & Latif (2015) also contributed in the favor of the study findings and stated that independence in audit and effective corporate governance are in contrast with earnings management practices. Furthermore, Salehi, A & Valahzaghard, K (2012) findings supported our findings in shape of significant effect of big five auditors on the quality of earnings. However, they opposed us in case of the board size by showing nil significance meanings to earnings quality. One more supported result is being suggested by Chi-Keung Man, et al in March/April 2013 and wrote that corporate governance may reduce or even diminish the degree of earnings management and author also emphasized that independent audit committees are main responsible to ensure quality and true information on financial reports.

Conclusion
From all prior results and discussion it can be concluded that corporate governance has an important role to some extent for promoting earnings quality by declining earnings management practices. In our case, audit quality and board size has negative significant effect in discretionary accruals. It depicts that in Pakistani firms big five

auditors firms are working in good manners for ensuring quality practices rather management practices. In Pakistani corporate culture the board size has also an important element to raise quality of earnings and the results suggested that small board size are very effective towards earnings quality. Similarly, in line with Pakistani society firms, who have large size, have ability to produce quality in earnings by diminishing discretionary accrual.

Future Research

The study is the most beneficiary for the corporate sectors in Pakistan as well as implication of this study can play smooth role at glob level. This study directed that audit quality and board size can be used to generate quality in earnings by reducing earnings management. In addition it is further suggested that corporate governance has many more proxies to raise the performance of the firm. Therefore , these other proxies may be taken to analyze quality by earnings management. It is further suggested that corporate governance effect may be captured with other proxies of earnings quality that is earnings smoothness and earnings persistence as well.

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