

Audit Committee Attributes and Share Price: Evidence from Banking and Finance Companies Listed on the Colombo Stock Exchange.

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Abstract

Past corporate collapses such as Enron, WorldCom, Xerox and similar others put a spotlight on the attention of corporate governance mechanism. The corporate governance mechanism is the system governing and controlling the activities of the companies. The importance of audit committees in ensuring the quality of corporate financial reporting has come under considerable scrutiny by both the academia and corporate governance regulatory bodies. The purpose of this paper is to examine the impact of Audit Committee (AC) attributes on the share price of Banking and finance sector in Sri Lanka.

The population of the study comprises firms listed under banking and finance companies listed in Colombo Stock Exchange. The number of firms listed under banking and finance sector on Colombo Stock Exchange as at the time of data collection (31st March 2018) was 72, out of which 26 firms were selected using simple random sampling method for this study. The data was collected for the period from 2011 to 2017 and obtained from the web site of Colombo Stock Exchange.

Size of the Audit Committee, Audit committee independence and Audit committee meetings are considered as independent variables of the study. The dependent variable was share price of the firm which was measured through share price. In addition to this, firm size, company age, board size was considered as control variables in this study. To test the hypothesis of this study, simple least square regression was utilized by using EViews 8 version.

The findings suggest a significant negative relationship between Size of the audit committee members, audit committee meeting and share price of banking and finance companies, while board size and company age is significant and positively related with share price. The audit committee independence is non-significant and negatively related with share price. Further the study revealed that there is negative and non-significant relationship between firm size and share price.

In this paper, the audit committee attributes that influence the share price most efficiently are identified. Due to lack of researches covering this area in Sri Lankan Banking and finance sector, this study would provide additional knowledge to future researchers and academicians.

Key words: corporate governance, audit committee, share price, banking and finance, Colombo Stock Exchange

BACKGROUND OF THE STUDY

Past corporate collapses at Enron, WorldCom, Arthur Andersen, Xerox and similar others put a spotlight on the attention of corporate governance mechanism. Following the Asian financial crisis, many emerging economies attempted to improve corporate governance to protect shareholder wealth, as poor governance was regarded as one of the main reasons for the massive decline in shareholder value during the crisis (Johnson, Boone, Breach & Friedman 2000; Mitton 2002; Lemmon and Lins 2003). Therefore many countries developed several mechanisms in order to govern the companies in an appropriate manner. The audit committee is one of the tools of such mechanisms to ensure the firm performance. Chartered Accountants in Sri Lanka (CA) has been at the forefront of issuing corporate governance principles in Sri Lanka.

The audit committee plays a key role in assisting the board to fulfill its oversight responsibilities in areas such as entity's financial reporting, internal control systems, risk management systems and the internal and external audit functions on behalf of the shareholders in order to ensure that the internal control activities are incorporating to the wealth maximization of shareholders. Therefore institute of chartered accountants of Sri Lanka, in their guidelines stated that the board of directors should require the audit committee to ensure carrying out the reviews of the process and effectiveness of risk management and internal controls, and document to the board and board takes the responsibility for the disclosures on risk management and internal controls. Under institute of chartered accountants of Sri Lanka, the board should establish an audit committee exclusively of non-executive directors with the minimum of three non-executive directors of whom at least two should be independent. If there is more non-executive directors, the majority should be independent. The committee should be chaired by an independent non-executive director. The board should satisfy itself that at least one member of the audit committee has recent and relevant experience in financial reporting and control.

Although it has been investigated by many researchers, contradictory findings are reported. At one hand, audit has significant relationship with stock prices (Al-Attar 2017), while on the other hand

it has no relationship with the stock prices of companies (Al-Thuneibat, et al., 2007). Due to such contradictory findings, it becomes the gap that whether audit exerts share prices, especially in listed banks of Colombo Stock Exchange. Therefore, there is a need to explore such influence. In this context, this study aims to find out the relationship between audit committee attributes, and its impact on the share price banking and finance companies listed on the CSE.

Through exploring such impact, this study will contribute academically in the research about Colombo stock market as well as practically for investors by highlighting the impact of the presence of audit committee, so that they would be confident about their investment decisions in Colombo stock market.

Given the above scenario, the major problem of this study is to determine whether audit committee attributes can significantly influence share price of listed banking and finance companies in Sri Lanka.

PROBLEM STATEMENT

The effect of the presence of an audit committee is a salient feature in the best practices of corporate governance. Most of the studies are concentrated on impact of audit committee attributes on firm performance (Gabriela 2016; Al-Matari, et al., 2012; Alqatamin 2018 and Amer et al., 2014). But there are a significant amount of researches conducted on impact of audit committee attributes on share price. Further different authors concluded different findings regarding the relationship between audit committee attributes and share price. For example, Yermack (1996) found that a small board size enhances firm value. Also Jensen (1993) asserted that having a small number of board members improves the efficiency of audit committee monitoring and control. On the other hand, there are some authors concluded that there is no significant relationship between board size and share price Anderson et al. (2004). Therefore by considering the different arguments found by different authors, the researcher has developed the statement, as follows, “To what extent audit committee attributes impact on share price”.

OBJECTIVES OF THE STUDY

The following can be mentioned as the objective of this study.

- To find out the impact of audit committee attributes on the share price of the banking and finance companies in Sri Lanka.

SIGNIFICANCE OF THE STUDY

For companies, in order to comply with governance rule of the companies, well establishment and appropriate operations of audit committee is important. In such way, the importance of this study stems from the following points:

- Stakeholders can be able to know whether the selected companies are adopting an effective internal control mechanisms.
- This study provides an evidence of whether or not the audit committee attributes affects the share price of the Listed Banking and Finance companies in Sri Lanka.

LITERATURE REVIEW

Empirical Study on Audit Committee Attributes on Share Price.

Using 105 New Zealand listed companies over a three year period, Rani (2011) conducted a research to find out the effects of audit committee characteristics on the value relevance of accounting information. In that study researcher found that there is no positive effect of audit committee expertise on the value relevance of accounting earnings. The study used primary variables as audit committee financial literacy and audit committee independence to answer the research question - what is the effect of audit committee expertise on the value relevance of accounting earnings. Value relevance is measured by regressing stock prices on earning and book values.

Focusing on a sample of 30 listed firms in Nigeria over a three year period, Uwuigbe & Olubukunola (2013) carried out a research to find out the association between corporate governance and share price. They revealed that ownership structure have a negative association with share price, whereas the audit committee is positively related to share price. And also the researchers recommended that board members' shareholding should be regulated to ensure an optimal share price disposition. Researchers focusing on global financial crisis also examine the relationship between Audit committee characteristics and firm performance during the global financial crisis. Example of this is Aldamen, et al. (2012) who, focusing on a total of 150 firms listed on the S&P300 during the period of the global financial crisis 2008-2009, show that smaller audit committees with more experience and financial expertise are more likely to be associated with positive firm performance in the market. They also find that longer serving chairs of audit committees negatively impacts accounting performance. The researchers used share price as the proxy for firm performances.

Ida & Asunka (2016), using a sample of 36 trading stocks on the Ghana Stock Exchange for the financial year of 2015, conducted a research to examine the effect of audit committees on the performance of firms listed on the Ghana stock exchange. They revealed that there is a relationship between the characteristics of the audit committees and the performance of the firms. Meanwhile, the number of independent members on the audit committee had no influence on the performance of the firms. However, the number of independent members of the audit committee with finance or accounting degrees impacted negatively on the firm's performance. And also they recommended that the corporate governance discussions should be re-focused from independence to more experienced and financial literate members on the audit committees and also a relatively longer tenure should be accorded the chairman of the audit committee of firms to enhance firm performance. Researchers measured firm performance using share price.

Okolie, & Izedonmi (2014), use a sample of 57 companies quoted on the Nigerian Stock Exchange over a period of six years carried out a study to find out the Impact of Audit Quality on the Share Prices of Quoted Companies in Nigeria and revealed that Audit Quality exerts significant influence on the Market Price per Share (MPS) of quoted companies in Nigeria.

Prior studies (Burgstahler & Dichev, 1997) focus directly on income smoothing, and find that firms manage earnings to meet analyst expectations and avoid losses and earnings decreases. Benefits from smoothed earnings include a perception of lower risk and a consequent reduced cost of capital, and by extension a high market price perception. Evidently, a variety of earnings management definitions exist but in the context of this study, earnings management defines the planning and execution of certain activities aimed at manipulating and smoothening income and achieving high earnings with a view to influencing the company's stock price (Revsine, 1991).

Based on a sample of 342 companies over a six year period from the Nigerian Stock Exchange, Okolie (2014) conducted a research to examine the association between Audit Firm Size and Market Price Per Share of Quoted Companies in Nigeria and stated that audit firm size exerts significant relationship and significantly influences market price per share of the companies in the sample. Further the researcher suggested that companies in Nigeria should improve their earnings quality only through sales growth and cost control strategies and present distinct reports on earnings quality. Furthermore, company auditors should issue Integrated Audit Quality Assurance Reports based on earnings quality assessment, statutorily backed by earnings monitoring of

companies in Nigeria while regulatory agencies should issue authoritative codes of best practice in Nigeria.

The evidence for audit committee attributes impact on share price is very rare. Researchers focused more on topics related the audit committee attributes and firm performance, and audit committee attributes and earnings management. For example Kankanamge (2016) examine the impact of audit committee characteristics on earnings management in Sri Lanka during the period from 2013-2015 using sample of 150 listed firms in Sri Lanka from 2012-2015. Audit committee size, audit committee independence, audit committee meetings and audit committee financial expertise used in this study as audit committee characteristics. Regression results showed a strong negative relationship between audit committee characteristics and earnings management in Sri Lankan listed firms.

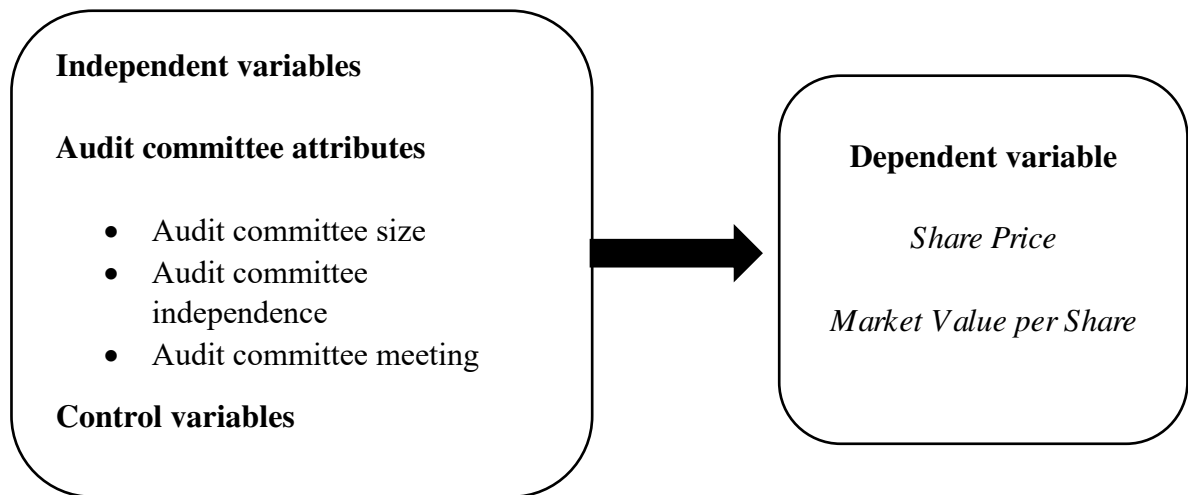
Balagobei (2018) examine the impact of audit committee on value relevance of accounting information of listed hotels and travels in Sri Lanka using the sample consists of 15 hotels and travels listed in Colombo Stock Exchange. Value relevance of accounting information is measured by earning per share (EPS) and book value per share (BVPS) while Audit committee consists of audit committee size, audit committee independence, audit committee experts and audit committee meetings. The results reveal that audit committee attributes such as audit committee size, audit committee experts and audit committee meetings have a significant impact on book value per share of listed hotels and travels in Sri Lanka. Further only audit committee experts influence earnings per share. Audit committee independence is not found to have a significant impact on the value relevance of accounting information.

Although the benefits of auditing are uncontroversial in developed markets, there is scant evidence about its effect in emerging economies. Auditing derives its value by increasing the credibility of financial statements, which in turn increases investors' reliance on them in developed markets. Chen, Srinidhi, & Su(2014) carried out a research to find out the effect of evidence using the evidence from variability of stock returns and trading volume and he suggested that investors rely more on audited financial information. The opinions from auditors of financial statements published by the companies, is significant on the volatility of the company's share prices. Hoti et al. (2012) conducted a research using Slovenian and Croatian public interest entities, with the aim to determine the effects of stock prices following the announcement of audited financial reports. The results show that the audit quality, the auditor's opinion have an impact on the evolution of

stock prices. In contrast, overall, this analysis shows that the audit reports investigated have information content for investment decisions. In particular, the qualifications expressed in the audit report have a negative effect on stock prices. It is also shown that an unqualified opinion with an emphasis of matter paragraph regarding going concern uncertainty or financial distress has a positive effect on stock prices.

CONCEPTUAL FRAME WORK.

After the careful study of review of literature the following conceptual model is developed by the researcher.



Source: developed by researcher

In the above model variables audit committee attributes are considered as independent variable and share price is considered as dependent variable.

Definitions of variables

Table 1: Variable Definitions.

Variables	Acronyms	Measures
Dependent variable		
<i>Share price</i>	<i>SP</i>	Obtained directly from CSE at www.cse.lk
Independent Variable		

<i>Audit committee size</i>	<i>AUSIZ</i>	<i>This was measured through number of members of audit committee elected by board of directors.</i>
<i>Audit committee independence</i>	<i>AIND</i>	<i>Measured by using number of independent directors in the audit committee</i>
<i>Audit meetings</i>	<i>AMEE</i>	<i>This variable measured through the number of annual meetings the committee holds.</i>
Control variables		
<i>Board size</i>	<i>BSIZ</i>	<i>This was measured through number of members held the position of board elected by shareholders.</i>
<i>Company age</i>	<i>CAGE</i>	<i>Measured using company's established year.</i>
<i>Firm size</i>	<i>FSIZ</i>	<i>Natural Logarithm of total assets was used to measure the firm size.</i>

HYPOTHESIS OF THE STUDY

Based on theory, previous studies and the research model outlined, this study has formulated the following hypotheses to examine the relationship between variables.

Hypothesis 1: Audit committee attributes significantly impact on share price.

The above hypothesis is further sub divided as follows:

Hypothesis 1a: Audit committee size significantly impact on share price.

Hypothesis 1b: Audit committee independence significantly impact on share price.

Hypothesis 1c: Audit committee meetings significantly impact on share price.

RESEARCH DESIGN

Data Collection and Sampling

This study utilizes the listed companies in Sri Lanka as its population. As the sampling methods differ in the type of study to be conducted, the research technique applied to get the sample of this study is the simple random sampling. This is where the selected 26 firms are the subset of the total 72 firms in the industry in which each firm of the subset has an equal probability of being chosen. A simple random sample is meant to be an unbiased representation of a group. Banking & finance sector was chosen because it is one of the largest sectors of Sri Lanka in term of number of companies. The sample size of the study is 26 companies out of 72 randomly selected from Banking & Finance companies listed in Colombo Stock Exchange. After computing variables as defined in Table 1 and screening, the paper end up with a panel of 181 firm year observations on 26 companies over the period 2011-2017 for this empirical study. The panel has an unbalanced structure. The research is based on secondary data. Audit committee attributes and share price were collected from annual reports, Handbook of Listed Companies and CSE official website. Data analysis is done with the help of software packages E views.

METHODOLOGY

To examine the extent to which audit committee attributes affects share price, we estimate following panel data regression model that links audit committee attributes with share price:

$$SP_{it} = \beta_0 + \beta_1 AUSIZ_{it} + \beta_2 AIND_{it} + \beta_3 AMEE_{it} + \beta_4 BSIZ_{it} + \beta_5 CAGE_{it} + \beta_6 FSIZ_{it} + \varepsilon_{it} \quad (1)$$

Where SP- Share price

AUSIZ- Audit committee size

AIND- Audit committee independence

AMEE- Audit meetings

BSIZ- Board size

CAGE- Company age

FSIZ- Firm size

ε – Error

i - Firms

t - Years

EMPIRICAL RESULTS

Descriptive Statistics

Descriptive statistics are useful to make general observations about the data collected. They report on the trends and patterns of data and provide the basis for comparisons between variables.

Table 2 presents descriptive statistics for the variables used in the analysis for our pooled sample. The pooled mean (median) Share Price is 170.4543 (63.20000), respectively. The average of Audit committee is 3.807692 (the median is 3.000000). The average of auditor independence is 2.747253 (the median is 2.000000). The average of audit meeting is 8.558011 (the median 8.000000). With respect to the control variables included in our model, the average board size of the firms is given by 9.285714 (9.000000). The average (median) company age is 29.34615 years (29 years). Finally the average size of the sample firms measured by total assets is about 1.25E+11 (3.04E+10) billion LKR.

These summary statistics indicate that the sample used in this study is comparable to those used in prior research in the context of Sri Lanka.

Table 2. Summary statistics

<i>Variables</i>	<i>Obs</i>	<i>Mean</i>	<i>Median</i>	<i>Std.Dev</i>	<i>Min</i>	<i>Max</i>
<i>SP</i>	<i>182</i>	<i>170.4543</i>	<i>63.20000</i>	<i>293.0469</i>	<i>0.000000</i>	<i>1597.000</i>
<i>AUSIZ</i>	<i>182</i>	<i>3.807692</i>	<i>3.000000</i>	<i>1.391111</i>	<i>2.000000</i>	<i>8.000000</i>
<i>AIND</i>	<i>182</i>	<i>2.747253</i>	<i>2.000000</i>	<i>1.137929</i>	<i>0.000000</i>	<i>6.000000</i>
<i>AMEE</i>	<i>181</i>	<i>8.558011</i>	<i>8.000000</i>	<i>4.946739</i>	<i>1.000000</i>	<i>33.00000</i>
<i>BSIZ</i>	<i>182</i>	<i>9.285714</i>	<i>9.000000</i>	<i>2.758355</i>	<i>5.000000</i>	<i>16.00000</i>
<i>CAGE</i>	<i>182</i>	<i>29.34615</i>	<i>29.00000</i>	<i>16.51438</i>	<i>2.000000</i>	<i>66.00000</i>
<i>FSIZ</i>	<i>182</i>	<i>1.25E+11</i>	<i>3.04E+10</i>	<i>2.16E+11</i>	<i>3.79E+08</i>	<i>1.14E+12</i>

Notes: This table reports summary statistics of the variables used in the study.

Correlation analysis

Table 3 reports the Pearson correlation coefficients between variables. To find out the relationship among variables correlation analysis was carried out. Audit committee size (AUSIZ) and audit committee meetings (AMEET) show a negative and statistically significant correlation with value of the firm measured by share price of the companies. This result is consistent with our hypothesis 1. Audit committee independence (AIND) shows a negative and insignificant correlation with value of the firm. This result is inconsistent with our hypothesis 2. However, confounding factors may be behind such opposite association; as we discussed in the methodology, we address this issue in the regression analysis that follows in the next section.

Turning to control variables, board size (BSIZ), company age (CAGE) have a significant impact on share price. But firm size (FSIZ) is insignificantly related to the share price.

Furthermore, Table 3 suggests that given that the observed correlation coefficients between independent variables are relatively low, multicollinearity should not be a serious problem in our study.

Table 3: correlation analysis

	AUSIZ	AIND	AMEET	BSIZ	CAGE	FSIZ	SP
AUSIZ	1.000000						
AIND	0.431481	1.000000					
AMEET	0.120854	0.200481	1.000000				
BSIZ	0.436275	0.398128	0.176499	1.000000			
CAGE	-0.156699	0.075603	0.000229	-0.170388	1.000000		
FSIZ	0.408621	0.420187	0.184959	0.298327	0.260352	1.000000	
SP	-0.245286	-0.145311	-0.151579	0.203644	0.246423	0.007045	1.000000

Regression Analysis

Table 4 demonstrates the findings of the regression analysis. The model expresses the effect of independent variable (audit committee size, audit committee independence and audit meetings) on share price.

Table 4: relationship between audit committee attributes and share price

Dependent Variable: Share price

Method: Least Squares

Sample: 1 182

Included observations: 181

<i>Variable</i>	<i>coefficient</i>	<i>Std error</i>	<i>t-statistic</i>	<i>prob</i>
<i>AUSIZ</i>	-67.69197	21.99727	-3.077289	0.0024
<i>AIND</i>	-19.16792	26.05431	-0.735691	0.4629
<i>AMEET</i>	-10.51004	3.965450	-2.650403	0.0088
<i>BSIZ</i>	48.36143	7.959221	6.076151	0.0000
<i>CAGE</i>	4.999493	1.310680	3.814428	0.0002
<i>FSIZ</i>	-8.75E-12	1.06E-10	-0.082670	0.9342
<i>R-squared</i>	0.278071	<i>Mean dependent var</i>	170.4569	
<i>Adjusted R-squared</i>	0.253176	<i>S.D. dependent var</i>	293.8598	
<i>S.E. of regression</i>	253.9506	<i>Akaike info criterion</i>	13.95006	
<i>Sum squared resid</i>	11221414	<i>Schwarz criterion</i>	14.07376	
<i>Log likelihood</i>	-1255.481	<i>Hannan-Quinn criter.</i>	14.00021	
<i>F-statistic</i>	11.17013	<i>Durbin-Watson stat</i>	0.812545	
<i>Prob(F-statistic)</i>	0.000000			

The above Table shows the estimated result of the model. R square shows that the model explained 27.8071 % of total variations of the dependent variable. It means that 27.8071 % of the changes in dependent variable are described by both independent and control variables. As a point of focus, the hypotheses of this study states that the audit committee attributes significantly impact on share price of banking and finance companies listed on CSE.

As observed, the results show that audit committee size has a coefficient of -67.69197 with t statistics of -3.077289 and with a p value of 0.0024. Thus, from the results, it can be stated that there is significant impact of audit committee size on share price. Audit meeting has a coefficient of -10.51004, with t-statics of -2.650403 and a p value of 0.0088. Audit meeting has significant impact on share price. Auditor independent has a coefficient of -19.16792 with t statistics of -0.735691 and with a p value of 0.4629. Auditor independence has not significant impact on share price. Board size and company age also significantly impact on the share price. The firm size shows that there is no significant impact on share price, thus has the p value of 0.9342. The results show that the F-statistics indicates the value of 0.000000. Which indicates that the model perfectly fits the study. Durbin Watson test is a test used to detect auto correlation. From the Table 4 Durbin Watson stat value is 0.812545. This value less than 3 indicating that there is no auto correlation issues.

CONCLUSIONS

The audit committee specially provides the control mechanism for the companies in order to ensure that the share holders' funds are appropriately utilized with in the firm. Control in the sense the published financial statements are free from material errors. Investors therefore value the audit report as a means of improving financial information reported by companies. This study provides evidence of the relationship among audit committee size, audit committee independence, audit committee meetings and the impact on share price for Sri Lankan banking and finance companies listed in CSE. The relationship between audit committee attributes and share price of Sri Lankan banking and finance sector companies, using least squares method. The study uses 181 firm year observations over the period 2011-2017.

The study documents a negative relationship between audit committee size and share price. This implies that the increase in audit committee members will cause a reduction in the share price. In some cases, if the members in a committee is large, this also can lead to conflicts within the committee. The different perspectives of the members can lead to inefficiency of the work carried out by the auditors. This result has supported previous research carried out by yermack (1996) and Jensen (1993)

Further auditor independent does not have a significant impact on the share price. This result has supported previous research carried out by Balagobei (2018), Rani (2011), Uwuigbe & Olubukunola (2013), which is not an expected result. Conversely, when entered into the regression with interaction of share price, it has negative coefficients, which are contradicting the value

relevance concept by implying that independence does not affect value relevance of accounting information.

Also audit meeting has negative relationship with share price. If the audit meetings get increase then, it will negatively affect the share price, which means the share price will get reduce. According to the corporate governance requirements, audit committee should meet four times in a year. But increase in the number of meetings can increase the work load of preparation for meeting and inefficiency of meetings can lead to a negative impact on share price. This result has supported previous research carried out by Elijah and Ayemere (2015).

In general, one of the important governance mechanisms, namely audit committee attributes, in particular, our study also provides new insights into the future directions of corporate governance reforms in Sri Lanka. Finally, in this study, we rely on quantitative and secondary data to test our hypothesis; but future research, using qualitative research methods such as questionnaire based survey or interview, could be conducted in order to complement our study.

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